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Report of the
Auditor General
of Canada
to the House of Commons

Chapter 11
Revenue Canada –
Combatting Income Tax Avoidance

May 1996

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This May 1996 Report comprises 12 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

© Minister of Public Works and Government Services Canada 1996
Cat. No. FA1-1996/1-11E
ISBN 0-662-24476-1
Copies françaises aussi disponibles

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Chapter 11

Revenue Canada

Combatting Income Tax Avoidance

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Revenue Canada

Combatting Income Tax Avoidance

Assistant Auditor General: Shahid Minto

Responsible Auditor: Barry Elkin

Main Points

11.1 The cost of tax avoidance is not known. However, the results of Revenue Canada's program to combat it indicate that avoidance continues to pose a serious threat to the tax base. The Department expects the program to produce about \$365 million in reassessments in 1995–96.

11.2 The Department has undertaken certain specific initiatives to combat and deter tax avoidance. The operations in the district offices we visited have produced significant tax reassessments.

11.3 Preventing avoidance can produce significant tax revenue. Moreover, it is crucial to the integrity of the self-assessment system. Our report has identified areas where opportunities exist to streamline operations and strengthen accountability.

Introduction

Revenue Canada has a program to combat income tax avoidance

11.4 Revenue Canada, which is responsible for administering the *Income Tax Act*, operates a program to combat tax avoidance schemes.

Tax avoidance schemes abuse the intent of the legislation

11.5 Taxpayers are entitled to arrange their affairs to minimize their tax costs. Avoidance occurs when such arrangements subvert the purpose of taxation provisions. Taxpayer-developed avoidance schemes were not contemplated by the legislators. They are contrary to the object and spirit of the law and frustrate its purpose. Unlike tax expenditure programs, which give relief to taxpayers who have fulfilled conditions that further the government's specific economic or social objectives, these schemes do not relate to any specific objectives and are seldom seen as furthering the general intent of the legislation.

11.6 The objective of the tax avoidance program is to discourage abusive tax-avoidance practices. Its main activities are to detect and examine

suspected arrangements or schemes through audits, and to develop policies and procedures to combat them. The schemes are usually complex. When a tax avoidance scheme is identified, Revenue Canada takes corrective action either by way of reassessment or by recommending changes to the legislation.

11.7 The Department allocates 150 auditors to the tax avoidance program. In the last four years, the program has used an average of 130 auditors. These auditors are located in 30 district offices across Canada; an additional 20 people work at headquarters. For 1995–96, Revenue Canada expects the program to produce about \$365 million in reassessments (including interest and penalties), or about \$2.6 million per tax avoidance auditor. The program is the second-highest producer of reassessments per auditor, with an increase of 45 percent over the last four years. (Exhibits 11.1, 11.2 and 11.3 provide additional statistical information on the program.)

11.8 We audited Revenue Canada's tax avoidance program at headquarters and selected district offices to see if there are opportunities for improvement. Our audit objectives, scope and criteria are

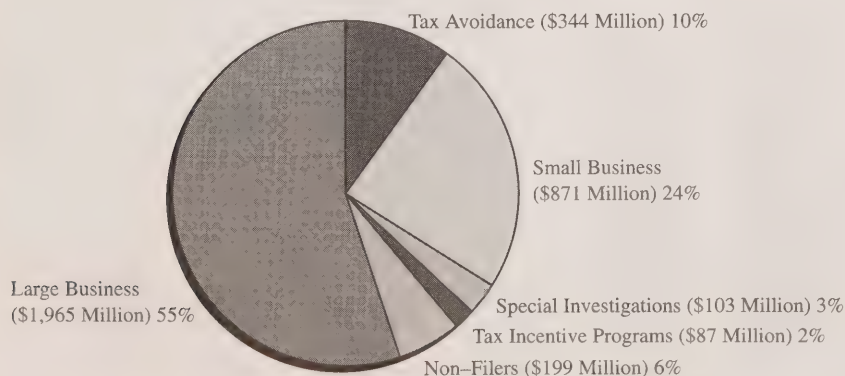


Exhibit 11.1

Tax Reassessments By Audit Program

(Average for the 1991–92 –
1994–95 period)

Source: Revenue Canada
1995–96 Part III Estimates

presented in more detail at the end of the chapter.

Observations and Recommendations

Strengthening the Law

The tax avoidance program is important

11.9 The tax avoidance program is essential to promote public trust and confidence in the fairness and integrity of the income tax system. Tax avoidance schemes have a negative effect on the equity and integrity of the tax system and on attitudes toward voluntary compliance.

Tax law contains measures to reduce avoidance

11.10 The primary tool of tax avoidance auditors in reassessing avoidance transactions is the tax legislation. The law contains specific provisions designed to counter abuse in certain circumstances. For example, in the tax shelter area, rules introduced in 1986 limit investors' deductions for tax shelter losses to the amount of money they have at risk. A system to register tax shelters

was begun in 1989. Additional measures were introduced in 1994 and 1995 to counter offensive financing arrangements, modify tax shelter identification rules and increase reviews and audits of tax shelters. The February 1995 Budget proposed additional requirements for information from corporations and individuals with offshore interests. Draft legislation for this Budget proposal was released in March 1996.

11.11 However, the volume of business and financial transactions and the pace at which new species of avoidance schemes are created do not allow the government to devise a specific legislative or administrative position that can counter all abusive transactions that may be developed in the future. So in 1988 the government introduced a general anti-avoidance rule to cope better with the wide variety of abusive schemes and to reduce the number of anti-avoidance provisions in the *Income Tax Act* that had contributed to its complexity.

Amending tax law is crucial

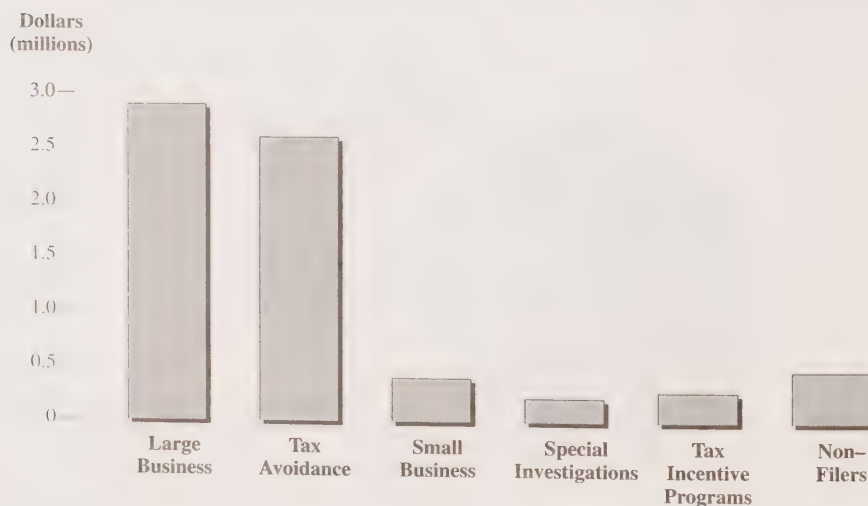
11.12 Revenue Canada's ability to deal efficiently with abusive transactions depends to a large extent on the provisions of the legislation. Problems in the

Tax avoidance schemes have a negative effect on the equity and integrity of the tax system and on attitudes toward voluntary compliance.

Exhibit 11.2

Tax Reassessments per Auditor by Audit Program

(Average for the 1991-92 - 1994-95 period)



Source: Revenue Canada
1995-96 Part III Estimates

application of the law need to be noted and corrected as soon as possible.

11.13 We noted that Revenue Canada has brought to the attention of the Department of Finance many situations suggesting that the law needed to be strengthened. When this is the case, it is customary for both departments to exchange views on the best way to modify the tax legislation.

11.14 Because of the complexity of the *Income Tax Act* and the nature of business transactions, amending the law can be a long process. For example, in 1989, changes to the rules dealing with non-resident corporations were requested by tax avoidance officials. The changes are still under consideration. In 1990, changes to rules dealing with forgiveness of debt were requested; the change was introduced in 1994 and became effective in 1995. In 1991, changes to the rules dealing with tax shelters were requested. These have not yet been finalized.

11.15 Our 1990 Report noted that the law enables a private foundation to loan back to a non-arm's-length donor all funds donated. Interest payments on the loan may also be loaned back to the donor. While Revenue Canada has reassessed some cases where donations were loaned back, and is pursuing other cases, no legislative action has been taken yet to stop these abusive schemes.

11.16 We noted that delays in legislative changes can result in further revenue losses, inefficient audits and numerous appeals.

Avoidance schemes designed to subvert draft legislation

11.17 The following example illustrates how quickly taxpayers can develop schemes to subvert proposed legislation. The February 1995 Budget proposed measures to eliminate the advantage that those who earn business income or professional income have over other Canadian taxpayers and that allows them to defer tax on an ongoing basis. The measure includes provisions to bring the

Dollars
(millions/auditor)

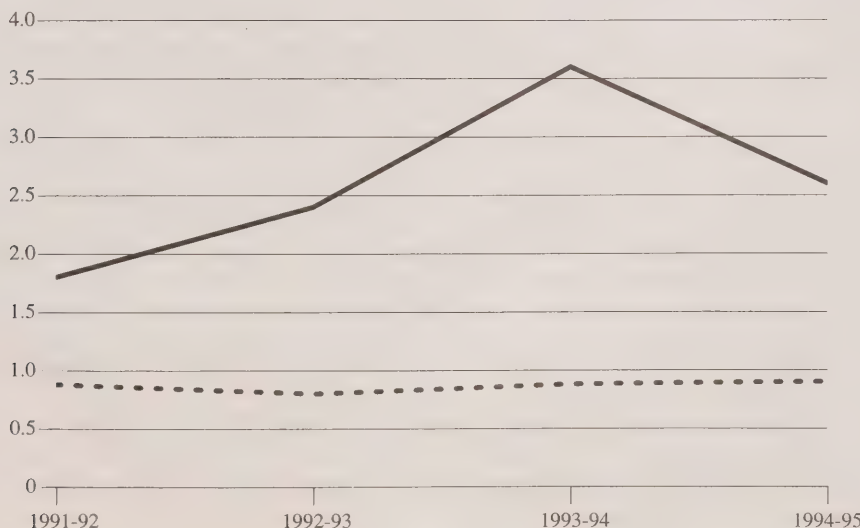


Exhibit 11.3

Tax Reassessments
per Auditor by Year –
Tax Avoidance and
All Audit Programs

(1991-92 to 1994-95)

Tax Avoidance Auditors ———
All Auditors - - - - -

Source: Revenue Canada
1995-96 Part III Estimates

deferred amount into income over a 10-year transitional period.

11.18 While the measures have yet to be finalized, affected taxpayers have found a way to subvert the intent of the new legislation and maximize the deferred amount, thereby reducing their 1996 income. These taxpayers may be able to increase rather than decrease the amount of income taxes previously deferred. Revenue Canada is aware of the nature of this scheme and its concerns have been discussed with Department of Finance officials. At the time of our audit the legislation was in draft form. Therefore, it is not clear if the schemes will be successful.

11.19 Revenue Canada should consult with the Department of Finance and examine ways to make required legislative changes sooner.

Department's response: In May 1995, the Tax Avoidance Program established the Identification, Detection and Legislative Co-ordination Section. Its primary responsibility is to ensure that required legislative changes are communicated promptly to the Department of Finance.

Compliance Strategy

Promised improvement to compliance strategy is still being developed

11.20 In 1994, Revenue Canada advised us that by June 1995 its compliance research division would develop an improved overall compliance strategy. We expected that the compliance strategy would indicate how the Department allocates scarce resources to the tax avoidance program. The Department has indicated that some of this information is included in its Part III of Estimates. At the time of our audit, the strategy was still being developed.

11.21 A well-articulated overall compliance strategy is both an essential departmental planning document and an accountability document that Parliament needs. Parliament provides the Department with \$2.1 billion annually and the Department employs some 39,300 people. Parliament should know the Department's rationale for the way it uses its resources.

11.22 For example, there is a growing interest by taxpayers in knowing how to divert income from Canada to an offshore tax haven. Exhibit 11.4 shows examples of how offshore service companies say tax havens can be used. Although Revenue Canada has initiated some measures to combat the use of these tax havens, we expect that its compliance strategy will explain how it will tackle such tax avoidance issues.

Improving the Detection of Abusive Tax-Avoidance Schemes

More attention to large corporations is needed

11.23 The responsibility to detect tax avoidance schemes rests primarily with tax auditors. When they suspect that a particular transaction is an abuse, they can consult with and/or refer the transaction to a tax avoidance auditor.

11.24 Departmental documents we reviewed suggest that large businesses represent a high-risk area that needs additional attention. Large corporations, particularly those with extensive domestic and foreign operations, have significant opportunities and resources to enter into tax avoidance schemes. About 5,000 entities are controlled by over 200 of the largest corporations in Canada. Exhibit 11.5 shows examples of avoidance

Exhibit 11.4

Examples of How Offshore Service Companies Say Tax Havens Can Be Used

Revenue Canada faces a considerable challenge to determine if a particular offshore arrangement is offensive.

Trading companies. An offshore trading company would be established to take orders directly from the customer but have the goods delivered to the customer by the manufacturer. The profits arising out of the difference between the purchase price to the company and the sales price to the customer would then be accumulated in either a tax-free or low-tax area.

Investment companies. Funds accumulated through investment companies set up offshore can be invested or deposited throughout the world. While returns or interest payable on these funds will generally be subject to local taxation, there are a number of offshore countries in which funds may be placed either in tax-free bonds or as bank deposits on which interest is paid before taxes are deducted. Similarly, in many offshore areas, capital gains are exempt from tax.

Holding companies. Use may be made of an offshore holding company that will fund the operations of subsidiaries in various countries so that the subsidiaries obtain the benefit of tax deductions for interest paid. The profits accumulated in a tax-free climate can be used to fund subsidiaries or reinvested in other ways.

Probate and privacy. A high net worth individual with assets in a number of countries may wish to hold them through a holding company so that, upon his death, probate would be applied for in the country where his holding company was incorporated rather than in each of the countries in which assets are held.

Property-owning companies. Advantages of offshore property ownership include avoidance of inheritance tax, avoidance of capital gains tax, and ease of sale. This is achieved by disposing of the shares in the company rather than the property owned by the company.

Professional services. Individuals who receive substantial fees for their professional services in capacities such as designers, consultants, authors or entertainers may assign to an offshore employment company the right to receive those fees. The offshore company may not have to pay tax on its profits, which can be reinvested in a tax-free climate to generate further income to the company. Payments to the individuals concerned can be structured in such a way as to minimize their tax liability. For example, offshore living expenses are paid, reducing the fees that would be paid to the individual.

Shipping companies. The use of offshore shipping companies can eliminate direct or indirect taxation on shipping. Shipping companies may own or charter ships and the resulting profits can be accumulated in a tax-free country.

Patent, copyright and royalty companies. An offshore company can purchase or be assigned the right to use a copyright, patent, trademark or know-how by its original holders, with a power to sublicense. Upon acquiring the intellectual property right, the offshore company can enter into agreements with licensees around the world who would be able to exploit the property right. It is preferable to acquire a patent at the pending stage before it becomes very valuable, so that any capital gain can be minimized. Often royalties paid out of a high-tax country to a tax-free country are subject to withholding taxes imposed in the high-tax country. In many cases an interposing holding company may allow a reduction in the rate of withholding.

Banking companies. Many offshore banking institutions have been established in tax havens. Many of these institutions are subsidiaries of major international banks. Such institutions pay interest without withholding tax and engage in international financing from offshore bases that are free from exchange controls. Such banking institutions and their associated trust companies are able to provide a wide range of financial services to their international clientele. Offshore banking institutions are also used by smaller business organizations, and in some cases by individuals, to act as offshore cash management centres.

Insurance companies. There are a number of offshore havens that are keen to encourage the establishment of insurance companies, which, like banking companies, bring employment and investment to the country of incorporation. In a number of offshore havens it is possible to incorporate insurance companies that pay no tax on their income from premiums or investments.

Captive insurance. Captive insurance companies have been created by many multinational companies to insure and re-insure the risks of subsidiaries and affiliated companies. Captive insurance companies are particularly suitable for the shipping and petroleum industries and for the insurance of risks that might otherwise be insurable only at prohibitive premiums.

Exhibit 11.4 (cont'd)

Trusts. Trusts may be used to protect assets from taxation or currency controls or potential creditors. They can provide a mechanism to pass on the benefits of assets without transfer tax or inheritance tax. Many countries have introduced anti-avoidance laws to lessen the advantages of offshore trusts and it is important that the trust is drafted carefully, with due consideration given to those anti-avoidance rules.

Shareholders and directors. Information we received deals with shareholders and directors of offshore companies. It points out that, under an offshore scheme, the arrangements of shareholders and directors can be critical. Typically, the shareholders of record will act as nominees or trustees for an undisclosed party and safeguard the beneficial owners for whom they hold shares in the company.

The directors would act as professional third-party directors and would be chosen so as to reside and meet in a fiscally neutral offshore jurisdiction, causing the company to be regarded as a resident in that jurisdiction.

The third-party directors are not referred to as nominee directors. They are third-party directors appointed independently of the ultimate owner of the company, but who might follow the suggestions of the ultimate owner on the basis that he would have a better idea of how the particular business of his company might be conducted.

The review of tax avoidance issues involving large businesses is not dealt with consistently and may not be given adequate attention by all district offices.

schemes involving large corporations that were detected by Revenue Canada.

11.25 However, according to a departmental report, the Department's large business tax auditors referred only 27 cases to the tax avoidance unit in 1994–95. Only one referral was made by its large business tax auditors in Toronto, where many large businesses are located.

11.26 We note that in Calgary, where tax avoidance auditors routinely review large corporations' files for tax avoidance issues in conjunction with large business tax auditors, significant reassessments result. The review by tax avoidance auditors takes place early in the audit process.

11.27 Our concern is that the review of tax avoidance issues involving large businesses is not dealt with consistently and may not be given adequate attention by all district offices.

11.28 The Department's recent draft policy for managing audits of large businesses acknowledges the problem. Under the draft policy, a large business audit team will consist of the large

business auditor and others, such as a tax avoidance auditor. In our opinion, the draft policy could be further strengthened by making mandatory the participation of tax avoidance auditors in defining the scope of large business audits.

11.29 Revenue Canada should ensure that large business files are reviewed adequately for tax avoidance issues.

Department's response: In the Department's new approach to the audit of large businesses, tax avoidance issues will be detected, examined and, when necessary, reassessed by the tax avoidance auditor who will be part of the large business audit team. "Real-time" audits will facilitate a much earlier detection of abusive tax avoidance schemes.

Large business scheme poses a serious threat to the tax base

11.30 Calgary tax avoidance auditors have identified avoidance schemes in the oil and gas sector involving the inappropriate use of losses totalling \$826 million.

11.31 The schemes involve joint exploration corporations. The purpose of the provision for joint exploration

corporations in income tax legislation is to attract investment in exploration and development activities in the resource sector, and to facilitate the operation of these activities as joint ventures while allowing the participants to enjoy the benefits of limited liability.

11.32 The *Income Tax Act* allows certain tax benefits to be passed on to shareholders of a joint exploration

corporation (JEC). The principal business of a JEC must be the exploration, development and production of oil and gas and minerals. The JEC can renounce, to one or more of its shareholders, resource expenditures it incurs up to an amount not exceeding the payment or loan made to the JEC by the shareholder.

11.33 The intent of the legislation is that the dollars invested in the JEC for

Exhibit 11.5

Examples of Avoidance Schemes That Involve Large Corporations and Were Detected by Revenue Canada

Weak Currency Borrowing

A Canadian corporation borrows in a weak currency with a high interest rate. It immediately converts the proceeds into Canadian dollars and enters into a forward contract to sell Canadian dollars and buy the weak currency at the debt's due date. The corporation ordinarily does not conduct business in the weak currency.

The corporation effectively obtains an interest deduction at a rate higher than the Canadian nominal rate and, through the forward contracts, it locks in a gain at the debt's due date. The corporation maintains that the locked-in gain is a capital gain.

The corporation's cost of borrowing can be reduced by as much as 200 basis points, and if it has unused capital losses to offset the capital gain the cost of borrowing can be reduced by a further 150 basis points.

Premium Priced Debt

A Canadian corporation wishes to raise \$100 and its current credit rating will allow it to borrow at 10 percent. Instead of borrowing \$100 at 10 percent, it issues a five-year debenture at a \$2 premium but agrees to pay interest at 10.4 percent.

The creditor recovers the \$2 premium through the increased rate of interest. The corporation maintains that the premium it received is not taxable, and it deducts the 10.4 percent interest it pays.

In substance, the premium is offset by higher interest payments over the term of the debenture so that the corporation pays the same 10 percent rate of interest as it would on a conventional borrowing. However, because the premium is not reported as income and the excess interest is fully deductible, the borrower achieves a lower cost of borrowing at the expense of the Canadian tax system.

On a borrowing of \$100 million at a 2 percent premium, the result would be a \$2 million tax-free receipt to the borrower and a \$1 million tax cost to the government.

Debt Swaps

An offshore subsidiary of a Canadian financial institution has unrealized losses associated with loans made by it to Less Developed Countries (referred to as LDC debt). The Canadian financial institution wishes to realize those losses in Canada rather than offshore.

The offshore subsidiary arranges to sell the LDC debt to a third party on the condition that the third party sell to the Canadian financial institution a similar debt. The LDC debt has been transferred to Canada. These debt swaps are reported for tax purposes as two separate transactions effected for cash. The Canadian financial institution can claim a higher prescribed reserve.

The Canadian financial institution can now realize the loss associated with its offshore subsidiary's LDC debt. Although the Canadian tax system has not received any tax associated with the interest on the debt, it bears the loss associated with the debt.

exploration and development activities should remain with the JEC to conduct those activities.

11.34 Avoidance schemes are used to thwart the intent of the law. The JEC rules are being used to defer tax by obtaining a premature deduction for exploration costs, and to inappropriately transfer expenses incurred by one taxpayer to another taxpayer. The 1996 Budget proposed to repeal the JEC rules.

The Application of the General Anti-Avoidance Rule

Tax avoidance auditors need information on the application of the rule

11.35 The general anti-avoidance rule was introduced in September 1988 to challenge avoidance schemes that would otherwise have been permitted under the law. Taxpayer reaction at the time focussed on the imprecise nature of the rule, which required auditors to use their judgment, and on the need for consistency in applying the rule. This led to the formation of an interdepartmental committee at headquarters to review and approve each use of the rule.

11.36 The committee comprises representatives of the departments of Justice and Finance, and of Revenue Canada's Income Tax Rulings and Interpretations Directorate, Legislative Policy Division, and Tax Avoidance Division. It began meeting regularly in 1992, the first year that tax returns for the 1989 taxation year were being audited. Before that, the committee had reviewed only requests for advance rulings where the rule could be applied to the proposed transaction.

11.37 To 31 October 1995, the committee had received 148 referrals. Of

these, 29 were approved for reassessments based at least partly on the rule, and 66 cases were still being considered for reassessment. In the other 53 cases the committee decided that the rule did not apply.

11.38 Revenue Canada is now auditing files from 1989 and later years, and we expect that in coming years referrals to the committee will increase.

11.39 It is now almost seven and a half years since the introduction of the general anti-avoidance rule. There has been no judicial interpretation of the use of the rule under the *Income Tax Act*. However, there are four cases before the Tax Court of Canada.

11.40 Our review of district office tax avoidance activities indicates that tax avoidance auditors do not understand the basis on which the committee has allowed the Department to reassess tax avoidance transactions using the general anti-avoidance rule. This is because each district office has knowledge only of the cases it has forwarded to the committee. Committee decisions on other cases are not communicated to district offices. As a result, district offices are not fully aware of either the committee's views on the application of the rule or the audit evidence the committee requires. Due to this lack of information, tax avoidance auditors sometimes do not understand the rationale for the committee's decisions and find it difficult to apply the rule.

11.41 Since the courts have not yet spoken, the committee remains the sole voice defining the way the rule is applied. The committee does not give reasons for its decisions and it does not cross-reference its decisions to other cases. Our work in district offices indicates that there is some confusion about the relationship between the rule and judicial anti-avoidance doctrines such

as sham and substance over form.

Although it is an advisory committee, not a quasi-judicial committee, we believe that its decisions need to be communicated to those in the field who are responsible for applying the rule.

11.42 Revenue Canada should ensure that tax avoidance auditors receive full and relevant information on decisions by the general anti-avoidance rule committee.

Department's response: Revenue Canada will continue to provide training on the general anti-avoidance rule and feedback on the decisions of the committee.

Settlement of Appeals

The appeals process does not provide feedback to tax avoidance auditors

11.43 After receiving a notice of reassessment, a taxpayer is entitled to file a notice of objection with Revenue Canada's Appeals Branch. District office appeals officers must forward to Appeals head office all of their proposed decisions to change the amount of tax reassessed on an avoidance issue. Only decisions to confirm the reassessment can be made by district office appeals officers. At this point, taxpayers often seek meetings with head office Appeals officers to propose settlements. Some of the cases we reviewed involved settlements.

11.44 The Department reports in its Part III Estimates that tax avoidance auditors generate, on average, \$2.6 million in tax reassessments each per year. However, the Department does not report amounts for reassessments that are vacated or changed at the Appeals stage.

11.45 In each of the district offices we visited, we followed the files we reviewed through to the appeals process. Although most of those files had been reassessed

more than a year earlier, over half were still awaiting a decision by head office. We estimate that for the four years ended 31 March 1995, the Appeals Branch disposed of over 500 tax avoidance cases. The tax reassessed was changed or vacated in over 45 percent of the cases. No information is kept on the number of settlements agreed to in Appeals.

11.46 We noted instances where the appeals process resulted in significant changes to reassessments made by tax avoidance auditors. In some of these cases, head office officials and legal experts from the Department of Justice had given opinions supporting the original reassessment. We observed that neither tax avoidance auditors nor legal experts were advised of the outcome of the appeal review or the reasons for the tax change. Because the appeals process can act as a means of audit-quality control, feedback to the avoidance auditor and others involved in the file would provide a useful learning experience.

11.47 Revenue Canada should ensure that when the Appeals Branch changes or vacates a reassessment, it provides tax auditors and other interested parties with relevant feedback.

Department's response: According to Revenue Canada's appeals inventory report system, in the four years referenced, a total of 4,143 objections were filed to reassessments involving tax avoidance, and 1,297 of these (31 percent) were changed or vacated. The information in the system identifies those reassessments that are vacated, but does not distinguish the specific reasons for modifications in those that are only changed. In many instances, reassessments can be varied for reasons not related to the tax avoidance issue under objection. Over the four-year period in question, the number of tax avoidance reassessments vacated (509)

The Department has issued 29 tax reassessments using the general anti-avoidance rule since 1988.

In a number of files we reviewed, the interest waived or cancelled amounted to several millions of dollars.

declined from 20 percent in 1991–92 to 5 percent in 1994–95.

Regarding the information kept on settlements, Revenue Canada notes that a group (or case) may include many objections. Although the Appeals Branch reports information on each individual objection, it does not report on a group or case basis. However, each settlement reached is fully documented and the tax at issue and tax retained are readily identifiable.

With respect to feedback to tax avoidance auditors and others, it is the Appeals Branch policy to encourage Chiefs of Appeals in district offices to feed back the outcome of the appeals process to Audit. The specific means and nature of this communication is at the discretion of the local office — it can be general or case specific.

Headquarters Appeals Branch generally advises Headquarters Tax Avoidance regarding the disposal of tax avoidance cases as part of the appeal process.

Interest Waivers

11.48 Fairness package legislation enacted in December 1991 provides the Minister with discretionary power to waive or cancel all or a portion of interest and penalties back to the 1985 taxation year. In addition to objecting to the tax reassessed, taxpayers may request that interest owing on the additional tax be cancelled by Appeals or that it be waived before it is reassessed by audit. Requests for an interest waiver or cancellation are reviewed and approved or rejected by committees in district offices.

11.49 We noted that interest waivers have constituted an element of settlements, at both the audit and appeals stage. In a number of files we reviewed, the interest waived or cancelled amounted to several millions of dollars. In 1994, the

Auditor General noted that the Department had not recorded the number of these fairness requests or the amounts of interest foregone. In April 1996, the Department planned to initiate a tracking system for fairness requests. However, we note that this system will record only the amount of interest cancelled by the Appeals Branch, not the amount waived while the file is being audited. Since penalties are rarely applied to tax avoidance reassessments, interest charges (which are not deductible for tax purposes) are usually the only deterrent available.

11.50 Exhibit 11.6 shows an example of a scheme identified by Revenue Canada where an interest waiver formed part of a settlement offered to all taxpayers involved. In some cases covered by the settlement, taxpayers had been reassessed and had filed a notice of objection. In many other cases, taxpayers were being audited and had not yet been reassessed. Under the new registry system, interest on reassessed files that is subsequently cancelled would be recorded. Interest not yet charged, but waived as part of a settlement, would not be recorded.

11.51 **Revenue Canada should review its directive to track fairness requests, to include interest amounts both waived and cancelled. It should also further clarify its policy governing the use of interest and penalty waivers to facilitate settlement of tax avoidance issues.**

Department's response: Revenue Canada notes that, although interest relief often arises in the context of settling a case, such relief could also be requested separate from any settlement. The ability to provide interest relief does assist in reaching settlements that are considered desirable, based on the merits of the case. The interest relief granted generally conforms to the Fairness guidelines.

Revenue Canada has recently concluded a review of the fairness provisions aimed at improving consistency in the application of the provisions. As a result of this review, the Department has harmonized and clarified the fairness provisions for penalties and interest for Income Tax, GST and Customs and issued them to field offices in March 1996. In addition, the implementation of on-line systems for tracking penalties and interest forgiven and to provide a central registry is scheduled for implementation on 1 April 1996.

Importance of Timely Advice from the Department of Finance

11.52 Upon a request by Revenue Canada, Finance advises it on the intent of tax legislation. This advice can play a key role in the disposition of tax avoidance cases.

11.53 When tax law is presented to Parliament it is often not accompanied by a clear statement of legislative intent. Because of this, Revenue Canada often asks Finance to provide the policy intent behind technical sections of the *Income Tax Act* and to comment on how the law should be applied to a specific transaction.

11.54 Our audit included the examination of tax avoidance cases that had initially indicated major tax reassessments but had resulted in no tax change. We sought the reasons for these results.

11.55 We observed that the audit of these cases had been carried out on the basis of the Department's current understanding of the policy intent. Both district and head office staff had spent hundreds of hours on these cases. In the final stage of the audit, the Department

During the 1987 and 1988 taxation years, 22 Canadian partnerships entered into a series of transactions to buy, with minimal cash, interests in a U.S. partnership (U.S. #1), which had operating losses and unrealized losses associated with its assets. The former U.S. partners of U.S. #1 created a new U.S. partnership (U.S. #2). Shortly after the purchase of U.S. #1 (in the majority of cases within a few hours) the Canadian partnerships sold all of the operating assets of U.S. #1 to U.S. #2.

The sale of its operating assets, added to its previously accumulated U.S. losses, resulted in U.S. #1 having tax losses of about \$340 million, which flowed through to the 22 Canadian partnerships and through them to 448 Canadian partners. The majority of investors in this scheme were tax lawyers and accountants.

Revenue Canada's tax avoidance auditors initially proposed to disallow the losses that U.S. #1 had realized on the sale of its operating assets. This position was supported by legal counsel.

In August 1994, 21 Canadian partnerships agreed to settle on the basis that the partnership losses would be disallowed but that the cash invested as the partnership interest would be treated as a capital loss. In addition, interest on the tax reassessed would be waived until May 1991.

Taxpayers who did not accept the settlement offer had the losses they had claimed fully disallowed; the cash invested in the scheme was not allowed as a deduction and the tax reassessed was subject to full interest.

At the time of our audit, 210 of the 448 partners had accepted the settlement offer. Taxpayers involved in four of the Canadian partnerships are appealing their reassessments. The Department is still accepting settlement offers from those who refused to take the initial settlement.

Exhibit 11.6

Revenue Canada Identified Schemes Involving Tax Lawyers and Accountants

sought advice from Finance on the policy intent, and abandoned the reassessment on the basis of Finance's advice.

11.56 If the Department had sought advice earlier in the process, it could have used these hundred of hours of work to audit other tax avoidance cases.

11.57 Revenue Canada should explore with Finance the possibility of seeking its advice and agreeing on interpretative issues earlier in the audit process.

Department's response: In recent years, the explanatory notes published with changes to the tax laws provide clearer statements of legislative intent. However, where such intent is not as clear as required, Revenue Canada will endeavor to seek the input of Finance as soon as a need for consultation is identified.

Tax Shelters

Measures have been taken to prevent abusive tax shelters

11.58 In very general terms, tax shelters are investments that are promoted on the basis that they offer income tax savings. Some produce large initial deductions in excess of the shelter's initial income. The deductions are then claimed against other income to reduce current tax liabilities. Others generate a stream of income with an offsetting stream of deductions. The legislation permits a taxpayer to deduct tax shelter losses only up to the amount invested or at risk. Tax shelters are usually structured in such a way that the current tax relief is based on the total amount invested, including any debt incurred to pay the investment. It usually exceeds the current cash required to purchase the shelter.

11.59 Film, computer software and real estate are the main activities financed by shelters. From 1992 to 1994, the value of

investment units offered by tax shelter promoters totalled about \$11 billion; taxpayers actually invested close to \$5 billion during the same period. If limited partnerships in mutual funds are deducted from that amount, the average taxpayer investment in tax shelters increased from \$53,000 in 1992 to \$158,000 in 1994 (see Exhibit 11.7).

11.60 An abusive tax shelter is one structured in a way that allows a taxpayer to deduct losses that exceed the amount at risk, or that overvalues the underlying asset of the shelter. Determining if a shelter is abusive is usually done through an audit. In the two years ended 31 March 1995, the Department's records indicate that it audited about 325 tax shelters and found most of them abusive. In 1995–96 the Department increased its audit coverage. The completed audits resulted in assessment of \$161 million in additional taxes.

11.61 As noted in paragraph 11.10, Revenue Canada and the Department of Finance took many steps in 1994 and 1995 to combat abusive tax shelters. Film tax shelters were found to be so abusive that in the 1995 Budget, the government announced a new tax credit system for film producers. The Department registers tax shelters prior to being offered for sale. The registration system does not discriminate between legitimate and abusive tax shelter offerings. It merely allows the Department to assign an identification number to the shelter. The registration system and partnership information returns are the databases most often used to select files for tax avoidance audit.

Abusive shelters continue to put pressure on the tax system

11.62 Auditing tax shelters is time-consuming and puts pressure on scarce tax avoidance staff resources.

There are over 1,700 shelters registered in southern Ontario, 730 of which are registered in Toronto. A tax shelter often involves more than 100 investors, each of whom has to be individually reassessed. Sixty percent of tax avoidance auditors in the Toronto office are involved in audits of tax shelters. Limited resources require district offices to select for initial review only those cases involving large sums of money.

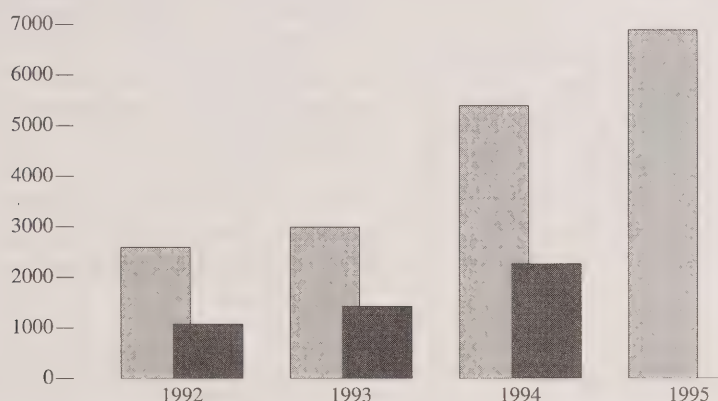
11.63 When a particular district office has initiated a tax shelter audit program, promoters have often registered subsequent offerings in another office that was not as aggressive. To further complicate the issue, shelters are now being structured as co-ownerships or joint

ventures to bypass the rules limiting the amounts that can be deducted.

11.64 The pressures that tax shelters put on audit resources continue at the appeals stage. For example, the Montreal district office audited 173 research and development tax shelters involving 8,000 investors and over 150 promoters. Most of the investors were reassessed and, in 1995, reassessments for about \$56 million were issued. To resolve the matter, in June 1995 the Department's Appeals Branch made a settlement offer to all of the investors. The settlement offer allowed the investors to write off their original net cash investment in the shelter. In addition, all the interest was waived. As of February 1996, 83 percent of the

Sixty percent of tax avoidance auditors in the Toronto office are involved in audits of tax shelters.

\$ millions



\$ thousands

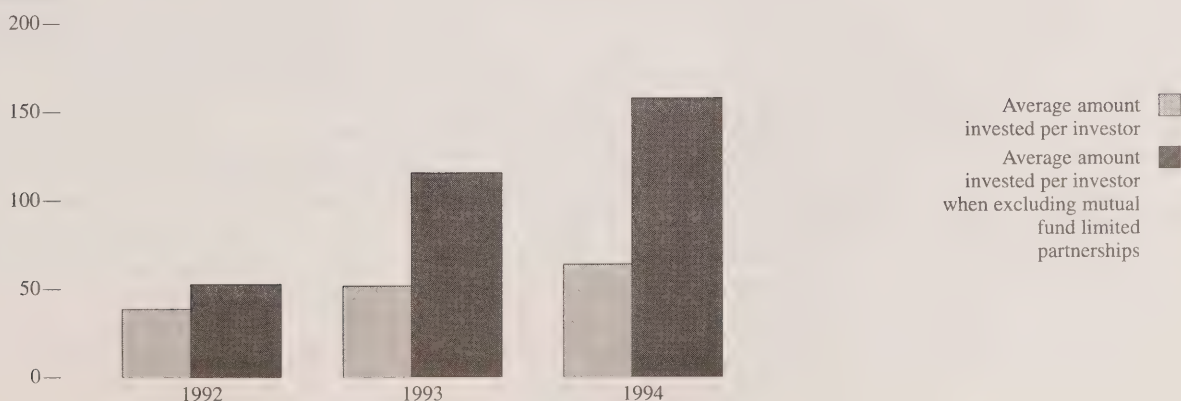




Exhibit 11.7

**Tax Shelters – Selected Data
1992 to 1995**

Registered 
Sold 

Average amount
invested per investor 
Average amount
invested per investor
when excluding mutual
fund limited
partnerships 

investors had accepted the settlement offer. Others are still considering court action.

11.65 Although the new legislative rules introduced in 1995 may reduce the future incidence of abusive tax shelters, we note that tax avoidance resources are still required to deal with tax shelters sold under the old rules.

Promoters of abusive tax shelters bear virtually no risks

11.66 Tax shelter audits focus on investors because they have benefited from tax relief measures associated with tax shelters. Aggressive promoters are often left untouched. They are subject to a penalty of up to 25 percent of the value of the tax shelter sold only when the tax shelter does not have an identification number.

11.67 Canadian law does not contain a penalty for promoting an abusive tax shelter. By comparison, in the United States, legislation was enacted in 1982 to permit the Internal Revenue Service to assert penalties against anyone who organizes, promotes or sells an abusive tax shelter.

11.68 The Department's only recourse against aggressive promoters is to prosecute them if tax fraud is suspected. We note that fewer than five promoters have been prosecuted in the last five years.

11.69 We observed a situation where a particular promoter has been promoting tax shelters for more than 10 years. His schemes have the same basic format. The investor is required to pay a certain amount in cash and the majority of the purchase price is financed by a promissory note. The investor writes off the entire amount of the purchase price as a prepaid royalty to an offshore company for

distribution rights to a certain product. The Department has audited many of the promoter's shelters and found all of them to be abusive. In most cases, no business was ever carried on. Many investors in this promoter's schemes have filed a notice of objection to their tax reassessments.

11.70 Revenue Canada should consider recommending to Finance an additional penalty for promoting abusive tax shelters.

Department's response: Revenue Canada will pursue this issue with the Department of Finance.

Rationale for granting of hardship waivers is unclear

11.71 Revenue Canada may reduce taxpayers' source deductions in cases of undue hardship. Investors in tax shelters have requested a reduction in their source deductions under this hardship provision when they expect their tax shelter losses to reduce their tax liability.

11.72 In Toronto, 541 requests for hardship waivers were received in 1994-95 and 486 were approved, at a total of \$4.3 million.

11.73 The law does not specify what constitutes "undue hardship". Since 1988, the policy of Revenue Canada is to grant hardship waivers for tax shelter investments if the requesting taxpayer can provide reasonable evidence that tax deductions from his/her income at source exceed the taxes that will be required at year end. A request for a "hardship waiver" for tax shelter losses will be rejected only when the shelter is being audited. Our review of audit files indicated that most audited tax shelters were found to be abusive.

11.74 Tax shelter promoters encourage investors to request hardship waivers as

soon as they purchase the shelter. This allows investors to finance the cash portion of their purchase through reduced source deductions.

11.75 Tax auditors have expressed concern that issuing hardship waivers may encourage investors to drop off the tax roll, since they need not file a return if they owe no tax or are not seeking a refund.

11.76 Revenue Canada should clarify what constitutes “undue hardship” and examine the feasibility of carrying out stronger review procedures before granting hardship waivers to tax shelter investors.

Department’s response: Tax shelter losses can be applied against income from employment. The Department permits a reduction in source deductions when it is reasonable to assume that the taxpayer will be entitled to claim the tax shelter loss. The source deductions are reduced to the amount necessary to meet the total taxes due for that year.

Revenue Canada may lack the legal authority to finalize settlements

11.77 In Exhibit 11.6 we note that four tax shelter cases before the Tax Court involve taxpayers who had rejected a settlement offer that was accepted by 210 of the 448 investors in the same abusive scheme. The taxpayers who accepted the settlement offer were taxed on a different basis from those who rejected the settlement.

11.78 It is not clear if the Department has the legal authority to assess identical transactions on a different basis.

Department’s comments: Revenue Canada can resolve cases only within the law. However, different interpretations under the law can be reached on the same

facts that give rise to the issue under objection or appeal. The Department, in conjunction with the Department of Justice, seeks to ensure that only sound cases fully supported by evidence proceed to litigation. This is not only good public policy but also recognizes the resource limitations of the courts and the Department of Justice.

The appeals process assists the parties in an action to evaluate the merits of the case. As a result, proposals to resolve the issue short of litigation often emerge during the process.

When an issue is common to a group of taxpayers, such as partners in a partnership, some may wish to settle and some may wish to pursue the matter in the courts. While the Department would prefer that a settlement be accepted by all parties in a group, this can be difficult to achieve when there are many in the group. Limiting an acceptable settlement to universal acceptance penalizes those who wish to resolve the matter and also increases the Crown’s exposure to risk. It should also be noted that cases that involve common issues may not be identical, even if they appear similar.

With respect to the cases referred to in Exhibit 11.6, an agreed settlement was offered to all participants.

Regarding the settlement of similar transactions on a different basis, Revenue Canada notes that it is not unusual that differing interpretive positions can be reached on the same facts, and in proceeding to the courts, pleadings often include alternative positions. Accordingly, the position advanced in the process of settling a case may differ from the position advanced if a settlement has been rejected and the case is pursued in the courts.

Issues Identified in 1994 Are Still Unresolved

11.79 In 1992, the Department's Program Evaluation and Internal Audit Division undertook a management review of the tax avoidance program. In late 1993, an action plan was prepared to make the program more effective at finding and deterring abuse.

11.80 Although some progress has been made, our examination of the action plan indicates that, after two years, many key recommendations of the review have not been implemented. A draft accountability framework prepared in 1994 has not yet been finalized. The framework includes performance indicators for tax avoidance auditors. Our 1992 Report had raised the need for performance indicators.

11.81 During the management review, tax avoidance auditors expressed the need for better access to legal advice to assist them in reviewing the transactions that are part of an abusive scheme, in order to improve the quality and timeliness of the audit. In the action plan, tax avoidance officials at head office indicated their intention to seek access to regional Department of Justice tax litigation counsel. However, Revenue Canada has not developed the link between tax avoidance auditors and Justice's tax experts in local offices. Our work indicated that there is a need for more timely and ongoing legal advice.

11.82 The action plan also included two initiatives to improve the use of electronic information for reporting and sharing tax avoidance audit results and for tracking the results of appeals on individual tax avoidance files. Little progress has been made in these areas. There is still a need for timely communication among district office tax avoidance auditors and between district offices and head office.

11.83 Revenue Canada should implement its Avoidance Program Review Action Plan.

Department's response: The status of the action plan is as follows:

- *Headquarters consulted with the Regions on the proposed accountability framework in 1995. It is expected that the framework will be fully approved by the end of 1996 with required computer system changes made by the beginning of the 1997–98 fiscal period.*

- *Additional resources would be required for Justice to hire the personnel to implement this initiative. Additional funds have not been allocated to Justice to implement this additional service.*

- *Revenue Canada has identified comprehensive electronic information reporting as a priority in responding to the needs of the compliance programs.*

Conclusion

11.84 The cost of tax avoidance is not known. However, the results of Revenue Canada's program to combat it indicate that avoidance continues to pose a serious threat to the tax base. The Department expects the program to produce about \$365 million in reassessments in 1995–96.

11.85 We noted that the Department has undertaken certain specific initiatives to combat and deter tax avoidance. We noted also that the operations in the district offices we visited have produced significant tax reassessments.

11.86 Preventing avoidance can produce significant tax revenue. Moreover, it is crucial to the integrity of the self-assessment system. Our report has identified areas where opportunities exist to streamline operations and strengthen accountability.



About the Audit

Objective

Our audit objective was to examine Revenue Canada's key activities designed to detect and combat abusive income tax avoidance and to determine whether there are opportunities to improve these activities.

Scope

Our examination included a review of tax avoidance operations and related activities at headquarters and in selected Tax Services Offices. It also included a review of tax avoidance audit files and the tracing of tax avoidance reassessments to appeals.

Criteria

The Department should identify areas of abusive tax avoidance and focus its detection efforts on high-risk areas.

The Department should optimize the use of tax auditors and tax avoidance specialists in the detection and reassessment of abusive tax avoidance transactions.

The Department should process tax avoidance reassessments within a reasonable time.

The Department should have guidelines to assist tax avoidance auditors in identifying cases where it is appropriate to accept a settlement.

The Department should disseminate to all district offices information on cases involving issues related to the general anti-avoidance rule.

The Department should recommend amendments to the income tax legislation, whenever appropriate, to counter tax avoidance.

Audit Team

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For information, please contact Barry Elkin, the responsible auditor.

Report of the Auditor General of Canada to the House of Commons – 1996

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Report of the
**Auditor General
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to the House of Commons

Chapter 12
Veterans Affairs Canada – Health Care

May 1996

**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 12
Veterans Affairs Canada – Health Care



May 1996

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Cat. No. FA1-1996/1-12E
ISBN 0-662-24477-X
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Chapter 12

Veterans Affairs Canada

Health Care

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Veterans Affairs Canada

Health Care

Assistant Auditor General: Wm. F. Radburn

Responsible Auditor: John O'Brien

Main Points

12.1 Canada fulfills its obligation to its war veterans, in part, through programs offered by Veterans Affairs Canada. The main funded programs of the Department are pensions, economic support and health care. For the last 10 years, health care has been the fastest growing program of Veterans Affairs, increasing in cost by 149 percent over that period because of jurisdictional issues, expanded eligibility for programs, improved benefits and inflation, particularly in the late 1980s.

12.2 The Department has not yet developed a comprehensive plan to meet the future health care needs of its clients for the following reasons:

- It has limited information on its future health care population. There is a significant population of veterans and members of the armed forces who are potential eligible clients and who could be eligible for Veterans Affairs health care benefits.
- The Department does not have a forecast of the likely changes in future health care needs of its client population and the impact of these changes on the Department's programs.

12.3 Veterans Affairs is committed to reducing the turnaround time for first-level approval of pension applications from an average of 18 months to 9 months, within two years. In future, we intend to audit the Department's success in meeting this goal.

12.4 There is a long-standing unresolved issue between Veterans Affairs and some provinces over responsibility for providing certain health care benefits to income-qualified veterans. The Department has identified approximately \$50 million that it is paying annually for these health care benefits.

12.5 In our opinion, the Department has satisfactory controls over eligibility for health care benefits.

12.6 The Department does not have national guidelines for the quality of long-term institutional care. Control over the cost of delivery in contract institutions is deficient, with weak operating agreements, budgets often received after the beginning of the fiscal year and backlogs in conducting operating reviews.

12.7 In implementing changes designed to improve the efficiency of delivery of the Veterans Independence Program, Veterans Affairs did not fully comply with conditions established by Treasury Board that required continuation of a post-payment verification system. We found weaknesses in the health care needs assessment process, also required by Treasury Board. The Department does not have adequate empirical evidence to demonstrate the impact the Program has on recipients' health or on helping recipients live independently in their homes and communities.

12.8 The Department has saved money by implementing controls for the provision of non-drug services to clients. It has also identified the need to improve controls for drug benefits and is in the process of developing a plan to implement these controls in 1997. The Department estimates that it could save \$7 million annually and improve the quality of care by implementing improved controls. In addition, the Department's method of controlling over-the-counter drugs is costly.

Introduction

Canada's Veteran Population

12.9 Almost 1,750,000 men and women have served Canada during wartime. Veterans Affairs Canada estimates that there were approximately 475,000 war veterans in Canada as at 31 March 1996 (see Exhibit 12.1 for the age profile and distribution by war). However, the Department currently provides benefits to a much smaller number of clients than the total estimated veteran population. In 1995–96, the Department reported that it had an overall client population of about 248,000, consisting of about 153,000 war veterans, 20,000 who served in regular forces during peacetime and 75,000 dependents.

12.10 The Department recognizes that the most important factor affecting the veteran population is that of aging. As shown in Exhibit 12.2, while the overall veteran population is expected to decline significantly by the year 2000, the percentage of veterans aged 75 and older will increase substantially.

Benefits Provided by Veterans Affairs

12.11 The three primary programs delivered by Veterans Affairs to its clients are disability pensions, economic support and health care.

Disability pensions

12.12 The Department administers pensions to former or, in some cases, present members of the armed forces who are suffering a disability due to an injury or a disease, or the aggravation of an injury or disease, that was incurred during military service in wartime, or that arose out of or was directly connected with

military service in peacetime. Surviving spouses and children may also be eligible for benefits, and compensation is paid to former prisoners of war. During 1995–96, the Department planned to spend over \$1.1 billion in pension benefits, with a delivery cost of \$18.6 million.

Economic support

12.13 The primary purpose of this program is to provide veterans and other eligible persons, through the War Veterans Allowance Program, with a guaranteed level of income. Other services provided by the economic support program are emergency financial aid, management of estates and trusts, provision of veterans insurance, grants to organizations that provide specialized veterans services, educational services for veterans and eligible children of deceased veterans, and funeral and burial grants. In 1995–96, the Department planned to spend \$136 million on these benefits, with a delivery cost of about \$17 million.

Health care

12.14 The health care program provides veterans and other eligible persons with health and social services. The main elements of the Veterans Affairs health care program are:

Exhibit 12.1

Age of Veteran Population by Type of War Service, as at 31 March 1996

War	Average Age	Population	Percentage
World War I	96	1,687	1
World War II	75	454,364	95
Korea	65	18,809	4
All War Veterans	75	474,860	100

Source: Veterans Affairs Canada Corporate Planning Division

Health care has been the fastest growing Veterans Affairs program.

- **Treatment and other health-related benefits.** The Department provides medical, surgical and dental examination and treatment, prosthetic and related devices, supplementary benefits, treatment allowances and other community health care benefits and services. In 1995–96, benefits provided under this activity were estimated to cost \$203 million.

- **Veterans Independence Program.** This activity provides services aimed at improving and maintaining recipients' health and independence in the home or community. The Department provides funding for home care, ambulatory health care, social transportation, modifications to homes and intermediate care in a community facility. In 1995–96, the Department budgeted \$167 million for these services.

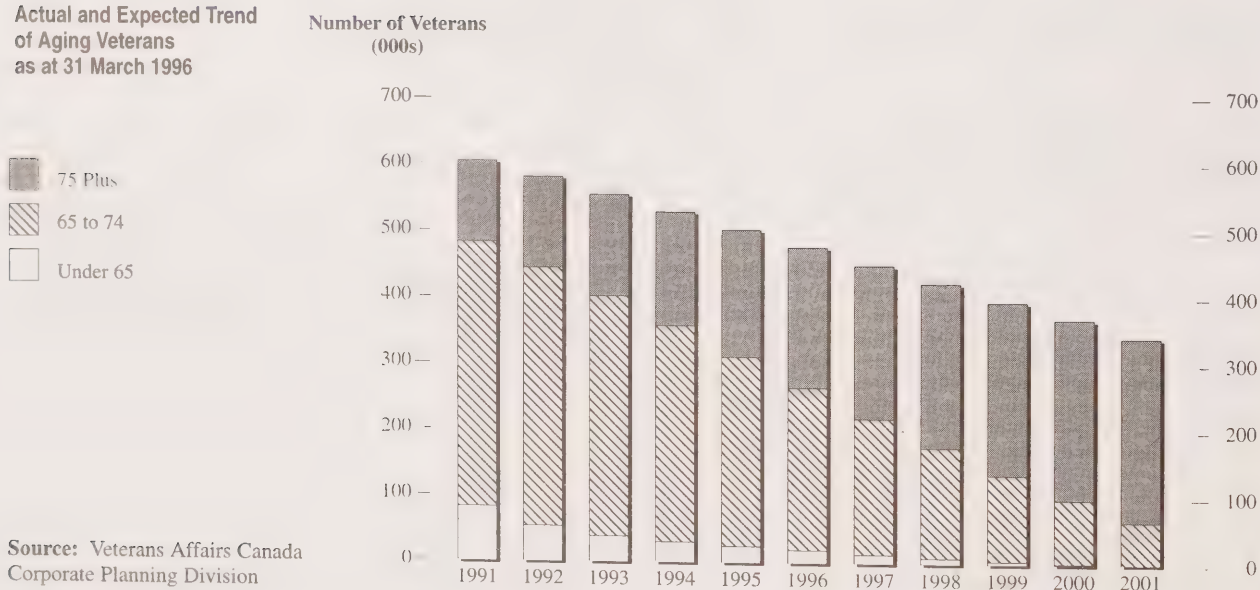
- **Long-term care.** The Department provides intermediate and chronic care in a departmental facility, priority access beds and community care facilities. In 1995–96, the estimated cost of this activity was about \$200 million.

- **Delivery.** The budgeted cost of delivery for health care in 1995–96 was \$58 million.

12.15 Exhibit 12.3 shows the percentage changes in departmental expenditures since our last value-for-money audit of the Department in 1986. During the interim period, pension costs have risen by 55 percent. This is due primarily to increases in the number of recipients, cost-of-living increases and changes in assessment levels. Economic support costs have declined by 68 percent. The primary reasons for this reduction are restrictions on access to economic support for veterans of allied countries, and aging veterans becoming eligible for Old Age Security and the Guaranteed Income Supplement, which results in offsetting reductions in War Veterans Allowance payments. Health care costs have increased by 149 percent because of ongoing jurisdictional issues with provinces, which are discussed later, expanded eligibility for programs,

Exhibit 12.2

Actual and Expected Trend of Aging Veterans as at 31 March 1996



Source: Veterans Affairs Canada
Corporate Planning Division

improved benefits and inflation, particularly in the late 1980s.

The Role of Veterans Affairs in Providing Health Care to Veterans

12.16 The Department's role in providing health care has significantly changed since World War II. At that time, most of veterans' health care needs were provided for in departmental facilities. Since then, as part of government policy, the Department has turned over most of its facilities to provincial governments. The services offered by the Department's health care program have also changed. Today, with the exception of the one remaining departmental facility, the Department relies primarily on provincial health care systems and other health care providers to provide health care services to its clients. It is responsible for reimbursing health care providers or the recipient for the cost of the service.

12.17 While Veterans Affairs uses the provincial health care systems and other providers to provide services to veterans, we found that the extent to which the Department actively managed rather than

acted as an insurer of health care varied across the country. The factors that affected this variation in role were:

- the program element — the terms and conditions of the Veterans Independence Program require active case management in the form of a health care needs assessment prior to the provision of benefits;
- location of the departmental facility — the Department currently has one facility that it operates; and
- provincial health care programs — the health care services offered vary by province. Veterans Affairs is more active in managing certain activities when they are not offered in a province.

12.18 We noted that because of the way the Department provides health care to recipients (primarily through contracts with health care providers), the level of health care services provided to a veteran is similar to that provided to other provincial residents. We also noted a number of examples where the level of service exceeds that provided to most other residents of a province.

Percentage Change since 1985–86

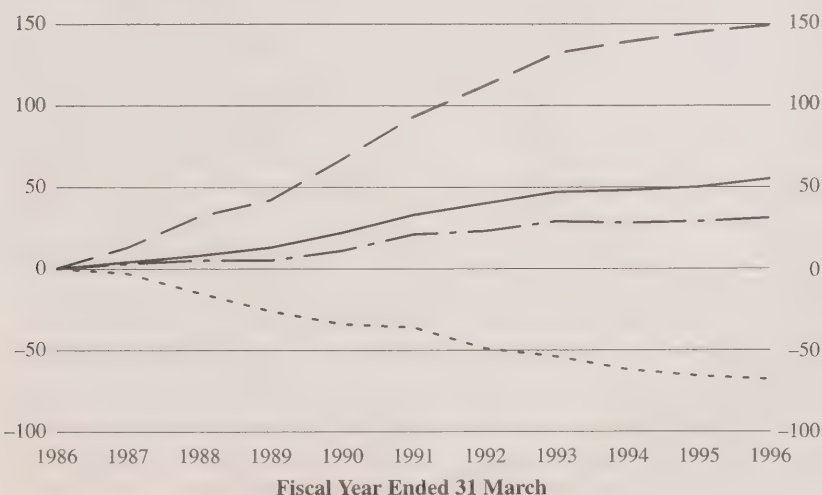
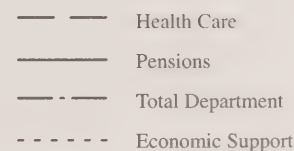


Exhibit 12.3

Trends In Activity Expenditures
1986 – 1996



Source: 1985–86 to 1995–96
Estimates – Part III

Pension Approval Process

It took 18 months, on average, to approve an initial pension award.

12.19 Pension clients represent a large proportion of the Department's health care clients. Lengthy turnaround times in the pension approval process can result in delays to clients in getting access to Veterans Affairs health care programs as well as in receiving pension income. For the pension approval process, because of significant changes to pension legislation in September 1995, our examination was limited to documenting current turnaround times and the Department's commitment to reduce these by 50 percent within two years.

12.20 Concerns over the timeliness of adjudicating and paying pensions are long-standing. Observations on the lack of timeliness in adjudicating pensions have been raised by the Office of the Auditor General (1980 and 1986), the Public Accounts Committee (1981), the McCracken Study (1982), the Special Committee to Study Procedures under the *Pension Act* (1984), the Nielsen Task Force (1985) and the Senate

Sub-Committee on Veterans Affairs (1994).

12.21 A major concern of these studies was the length of time it took to reach a decision on a disability claim and to begin or adjust disability pension payments. In 1986, our audit found that for first payments made in the month of December 1985, it took about 13 months on average from the date of application to the date the benefit was paid. However, turnaround times have subsequently increased to the point where the Department reported it has been taking an average of 18 months to reach a first decision resulting in a disability pension award. We corroborated this departmental information. In addition, the Department reported that it took an average of three years to reach a final decision if all levels of appeal are exhausted. Exhibit 12.4 shows the distribution of turnaround times for all applications resulting in an initial pension payment during the 1993 to 1995 period.

12.22 In September 1995, legislation came into effect that streamlined the

Exhibit 12.4

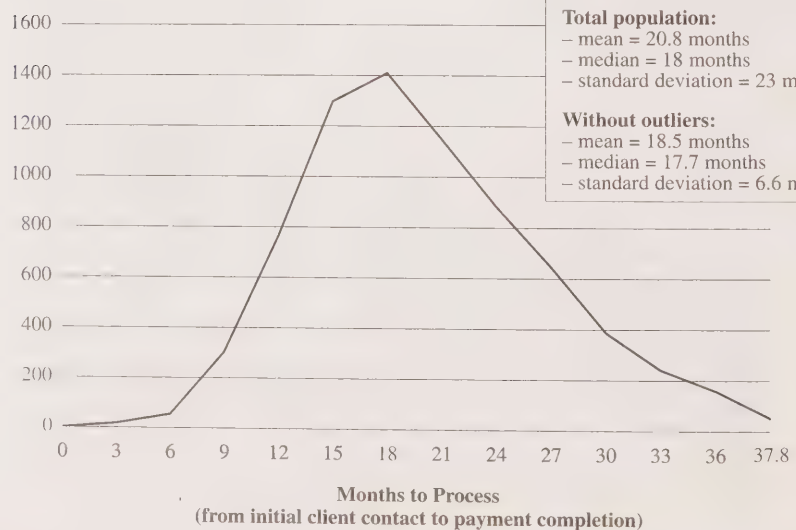
Pensions Process 1993–1995 Turnaround Times

Outliers:

Cases that required 37.8 months or more to process were treated as outliers and were analyzed separately. The outliers include 237 cases that required up to 5 years to process, 50 cases that required between 5 and 10 years to process and a further 27 cases that required between 10 and 50 years to process.

Source: Veterans Affairs Canada,
Pensions Status Enquiry System

Cases Processed for Payment



pension approval process. The legislation resulted in the following changes:

- The authority to make first decisions on entitlement to pension benefits, previously the responsibility of the Canada Pension Commission, was transferred to the Department.

- Responsibility for preparing applications, previously the responsibility of the Bureau of Pension Advocates, was given to departmental officials in district offices.

- The Bureau of Pension Advocates, previously a separate agency responsible both for the preparation of first applications for pension benefits and for advocacy services for appeals, was integrated into the Department and given the mandate to deal solely with appeals.

- The Canadian Pension Commission and the Veterans Appeal Board, each previously responsible for initial decisions and for separate levels of appeal, were combined to form the new Veterans Review and Appeal Board. The new Board will hear first and second appeals.

12.23 As part of the process of obtaining approval for the new pension legislation, the Department is committed to reducing pension turnaround times by one half. As can be seen in Exhibit 12.4, for many applicants, reducing the turnaround time by one half will still leave a lengthy wait for approval. In future, we intend to audit the Department's success in reducing turnaround times.

Observations and Recommendations

12.24 Our audit focussed primarily on the Department's delivery of health care to veterans. This function has been the fastest growing area of expenditure in the Department and, with the projected aging of the Department's client population, it is

anticipated that the health care needs of these clients will continue to rise. Details concerning the scope and objectives of this audit can be found at the end of the chapter in the section "About the Audit".

Planning to Meet the Future Health Care Needs of Clients

Background

12.25 Increasing demands for planning information have made the Department question the functionality and reliability of its program forecast models. During 1995–96, the Department started a major initiative, with the assistance of Statistics Canada, to address data deficiency problems and to refine its forecast methodology. These projects are planned for completion in late 1996. In addition to the planned improvements to the current forecasting systems, there are still many variables that are not well understood or tested (for example, evidence of the extent of progression in pension disability over time; new client intake for the pension program, particularly for regular forces; and acceleration in demand for treatment services). These areas of uncertainty impact directly on the Department's planning activities.

Veterans Affairs needs a more comprehensive plan to meet the future health care needs of its clients

12.26 At the time of our audit, the Department did not know the extent of human, financial and physical resources that it will require in the future to meet the health care needs of its client population. We believe this is a serious concern because over the next five to ten years the health care needs of veterans are likely to increase, perhaps dramatically. To meet its obligations while controlling costs, it is important that the Department continue to improve the reliability of estimates of the

The Department has limited information on its future health care population.

The Department has not forecast the future likely health care needs of its clients.

number of future health care clients; obtain more detailed information on the potential health care needs of those clients; define the services it intends to provide; and begin making the necessary arrangements to provide those services.

12.27 Veterans Affairs has two major problems in developing a comprehensive plan to meet the future health care needs of its clients:

- The Department has limited information on its future health care population. There is a significant population of veterans and members of the armed forces who are potential clients and who could be eligible for Veterans Affairs health care benefits.
- The Department does not have a forecast that reflects likely changes in future health care needs of its client population and the impact of these changes on the Department's programs.

12.28 The Department has prepared a 10-year planning perspective document that identifies these and other strategic issues facing Veterans Affairs. However, it

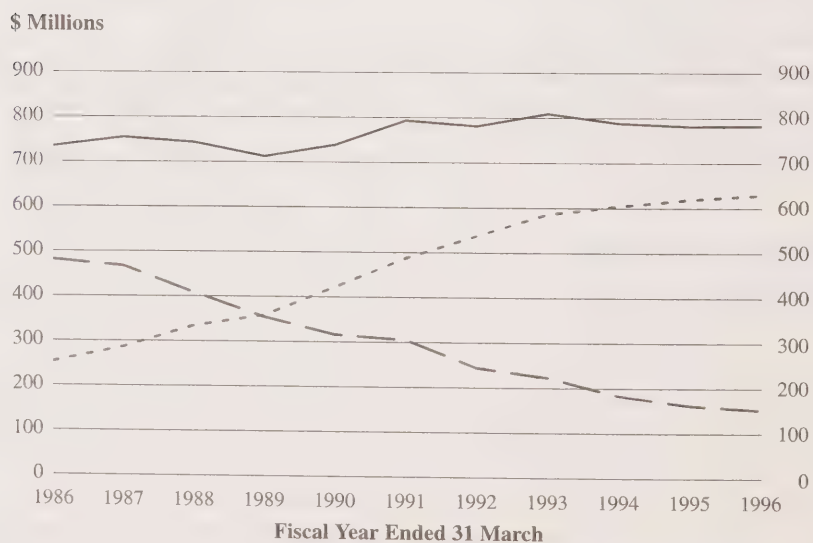
has not yet developed a complete plan for dealing with these issues.

12.29 The role and clientele of Veterans Affairs have evolved since the end of World War II. During that period, the government changed veterans programs and expanded the eligibility for veterans benefits. For example, in 1981 the Department introduced the Aging Veterans Program for pensioners. In the mid-1980s, this program evolved into the Veterans Independence Program (VIP), which provides benefits to pensioners and income-qualified veterans. In 1989, the government expanded VIP eligibility to cover veterans who served in Canada for at least one year during wartime (Canada Service Veterans). At the time these decisions were made, they did not greatly increase the Department's overall budget because the increased costs were largely offset by the rapid decline in economic support. As shown in Exhibit 12.5, economic support expenditures declined from \$481 million in 1985-86 to \$153 million in 1995-96 (a decrease of \$328 million) while the cost of health care rose from \$253 million in 1985-86 to \$629 million

Exhibit 12.5

Health Care and Economic Support Expenditure Trends 1986 - 1996

— Health Care and Economic Support
 - - - Health Care
 — Economic Support



Source: 1985-86 to 1995-96 Estimates - Part III

during the same period (an increase of \$376 million).

Veterans Affairs does not have an accurate projection of its future client population

12.30 Statistics on the veteran population are derived largely from 1971 census data. These data are now 25 years old and certain statistics may no longer be accurate (for example, the projection of veterans who served overseas). Attempts by the Department to get a question about veterans included in the 1996 census were unsuccessful. The Department estimates there are now approximately 475,000 veterans in Canada. However, only 153,000 or 32 percent of these veterans are currently accessing Veterans Affairs benefits. Some veterans are not eligible for benefits because they do not meet the eligibility criteria specified in legislation or they are not income-qualified, while many others are healthy and do not need health care benefits at this time. The Department also provides benefits to former and, in certain cases, current members of the regular forces and the reserves.

12.31 As shown in Exhibit 12.6, the Department estimates that, in the 2006 fiscal year, there will be about 142,000 veterans eligible for health care benefits. The Department also estimates that there will be an additional 70,000 veterans who will not meet the eligibility requirements for health care benefits. Based on historical participation rates and consumption patterns, the Department estimates that only 80,000 veterans will actually access departmental health care benefits. However, studies have shown that vulnerability and dependence on others increase significantly beyond the age of 75. These findings suggest that the historical participation rates and consumption patterns used in the Department's forecasting model may not be appropriate for a population, such as the veteran population, with an average age of 75. Therefore, the Department could be significantly underestimating the number of future health care clients.

12.32 Any former member of the armed forces with a service-related injury is a potential health care client of Veterans Affairs. Exhibit 12.6 also shows the

The Department could be significantly underestimating the number of future health care clients.

Thousands

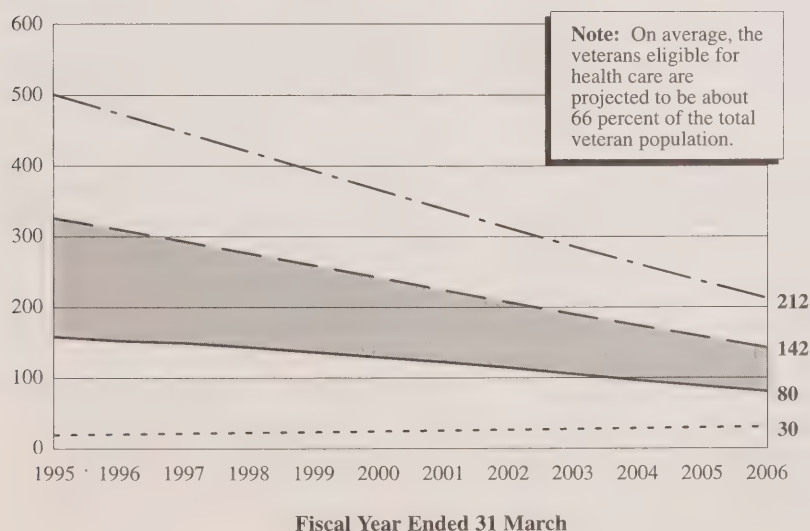
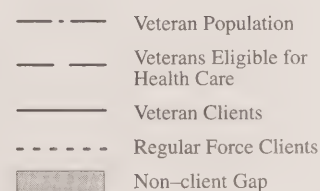


Exhibit 12.6

Projected Veteran Population and Clients 1995 to 2006



Source: Veterans Affairs Canada
Corporate Planning Division

The Department's forecast does not adequately consider the impact of aging on health care needs.

Department's projection of regular force clients. The projected growth is very modest but even at that rate regular force clients will become the largest client group by the year 2016. Recent experience has shown actual intake of regular force clients to be higher than numbers forecast. The Department has limited information on key characteristics of potential regular force clients, such as the size of the potential client population, the rate of program intake and special or unique health conditions. To date, limited resources have been committed to studying the characteristics of this client group.

12.33 Our 1980 audit observed that Veterans Affairs had little data on the current characteristics and needs of the veteran client population. In addition, similar concerns were raised by the Public Accounts Committee in 1981 and in our 1986 audit of the Department. The 1986 audit noted that the Department did not know how many veterans were eligible for its programs or how much of the target population it was reaching. Although improvements have been made recently, these deficiencies continue to exist at Veterans Affairs and remain an area of concern.

An aging population has specific health care needs

12.34 Exhibit 12.1 shows that the veteran population is an elderly population with an estimated average age of 75 at 31 March 1996. Health generally declines with age. Departmental officials anticipate that the major health care needs of this elderly population will be dementia, immobility and loss of caregiver support. Departmental studies have shown that, other than differences from being predominantly male, the health care needs of the veteran

population are not significantly different from those of other elderly groups.

Veterans Affairs has not fully assessed the impact of the changing health care needs of its client population

12.35 Until recently, the Department had devoted limited resources to determining the needs of its future client population. Exhibit 12.2 shows that the vast majority of the Department's potential client population will be over age 75 by the year 2000.

12.36 Those who served in World War II, the majority of Canadian war veterans, are clustered around the average age. Departmental and other health studies have shown that health tends to decline slowly until around age 75. After that age, health care needs tend to increase significantly. The narrow distribution of the average age of the veteran population around age 75 suggests that their health care needs could increase rapidly in the near future. However, the Department's forecast model does not adequately consider the impact of aging on the extent of such needs.

The government faces a significant potential liability

12.37 Veterans Affairs could face significant unplanned costs from underestimating the size and health care needs of its future client population. This potential future liability is large. The annual cost of maintaining a veteran in a chronic care facility ranges from about \$50,000 to \$80,000. The maximum approved rate that the Department will pay to maintain a client in a community care facility is about \$90 per day or \$33,000 annually. Canadian studies have shown that approximately 9 to 10 percent of men over age 65 are in institutions. Departmental data indicate that veterans are institutionalized at an earlier age than

non-veterans. In addition to the cost of long-term care, the Department would also be responsible for treatment and drug benefits. These additional costs could be incurred within a short period because of the narrow clustering of the age of veterans around the average.

12.38 The Department faces the risk that it may not be prepared for a possible increase in demand for its services over the next five to ten years. In order to assess whether this risk is real, it needs better information on its potential client population and their health care needs.

12.39 Veterans Affairs Canada's long-term plans for health care should include the following:

- an improved estimate of the number of potential health care clients in the next five to ten years;
- a complete assessment of the potential health needs, and associated costs, of new and present health care clients; and
- an implementation strategy to meet the health care needs of the future client population.

Department's response: The Department agrees that it is important to improve estimates of the impact of aging on health care needs and in the near future will be completing the work already started with respect to these needs.

New estimates of health care clients and their associated costs for the ten-year period commencing with fiscal year 1995–96 are currently being finalized. The new forecasts of expenditures involve assessing the future health needs of the number of estimated clients.

Assessment of potential health needs is an ongoing initiative of the Department. The Department is currently acquiring and assessing detailed data on health-related behaviours in the senior veteran and

senior non-veteran populations. This initiative is directed to assisting the Department in determining the future health needs of its current veteran clients, as well as to assisting in determining the health needs of forecasted veteran clients who currently do not access departmental benefits and services.

Jurisdictional Issues

Responsibility for health care

12.40 The delivery of health care in Canada is a provincial responsibility with minimum standards established under the *Canada Health Act*. Canadian citizens have the right to access certain minimum health services wherever they reside in Canada. However, provinces may choose to provide additional benefits that are not health-insured benefits under the *Canada Health Act*.

12.41 Veterans Affairs legislation defines who is a veteran and describes the federal government's responsibility for providing services to eligible veterans, including health care. This responsibility includes the following:

- For those in receipt of a veteran disability pension, Canada is responsible for all health care benefits associated with the pensioned condition, except that pensioners are required to apply for provincial programs before accessing the Veterans Independence Program.
- Other qualified recipients are to have access to all the benefits as residents of a province first and then receive any additional benefits from Veterans Affairs. As an example, in those provinces that have a seniors pharmacare program, veterans are to receive benefits from the provincial program and then receive benefits from the Department for any co-payment portion. In other words, for these clients, the intent of Veterans Affairs legislation is to provide treatment and drug benefits and Veterans Independence

The intent of Veterans Affairs legislation is to provide qualified recipients with a "top-up" of provincial programs.

The Department has negotiated agreements with a number of provinces that recognize that, except for pensioned conditions, veterans are eligible for the same health benefits as other residents of a province.

Program benefits as a “top-up” of provincial programs, where they exist, or to provide such benefits where a province does not provide them.

Responsibility for veterans health care

12.42 During our review of veterans health care issues, we noted that the Department is paying for benefits that are not its responsibility under its legislation. This is because some provinces do not provide the same health care benefits to veterans as those provided to other residents of the province. Based on the requirements of its legislation and instructions from Treasury Board, Veterans Affairs has negotiated agreements with a number of provinces that recognize that, except for pensioned conditions, veterans are eligible for the same health benefits as those provided to any other resident of a province. Notwithstanding this provision, a number of provinces have established their seniors drug programs as a “payer of last resort”, or they simply refuse to pay for veterans’ drugs. These provisions effectively eliminate veterans from eligibility for the provincial drug plan. Provinces can exclude veterans from coverage because seniors drug programs are generally not an insured benefit under the *Canada Health Act*. Where provinces have adopted the payer of last resort policy or refuse to pay for seniors’ drugs, the Department pays the full cost of drug benefits; however, the intent of the federal program is that veterans will access the provincial drug program in the same manner as any other resident.

12.43 In 1993–94, the Department estimated that it was paying approximately \$50 million annually for health benefits that would normally be available to a resident of a province.

12.44 Since 1990, Veterans Affairs officials have had discussions and exchanged correspondence with the provinces on this issue, but have been unable to resolve it. During that period, the Department has continued to accept responsibility for these costs even though they are not its responsibility under existing legislation and government policy, and it was not the government’s intent to pay the full cost of drug benefits, in all cases, when the program was established.

12.45 This issue is common to other departments that have federal health care clients. Veterans Affairs has been given the lead role in developing a co-ordinated strategy for federal health care clients but has not yet made significant progress.

12.46 It can be argued that this issue is one where there is no real harm. After all, the recipients are eligible for the health care benefits from either a provincial or the federal government, and ultimately all levels of government are supported by the same taxpayers. However, both levels of government have to maintain administrative structures to determine eligibility and either pay the cost or refer the charge to another level of government. Furthermore, in situations where accountability is not clear, it becomes difficult to assign responsibility for managing delivery cost-effectively. These situations can also be difficult for the recipient population, particularly an elderly one, because individuals may be referred to different agencies for the funding or provision of services.

Cost-sharing issue is not new

12.47 Sixteen years ago, in our 1980 Report to Parliament, we noted instances where the Department was paying for health care services for veterans that would usually be provided to all residents

of a province. The Auditor General recommended that “the Department should continue to seek methods to arrive at an equitable sharing of health care costs between federal and provincial authorities.” As noted in paragraph 12.61, significant differences continue to exist in the cost per patient-day for long-term care. The current concerns over responsibility for veterans drug benefits began in 1990.

Opportunities for co-operation with provinces may exist

12.48 The provincial health care systems are the primary deliverers of health care in this country. Veterans Affairs runs a separate system for a relatively small number of clients. The Department is examining the need to hire more health care staff to manage the care of its clients. In addition, there may be opportunities for the Department to expand its use of Canada’s existing health care system to serve its clients more efficiently. As long as funding conflicts exist, it is difficult to take advantage of these opportunities.

Eligibility for Health Care Benefits

Who is eligible for veterans health care benefits?

12.49 Eligibility for veterans health care benefits is specified in various pieces of legislation. Generally, in order to be eligible for health care benefits, a recipient must be eligible to receive a disability pension, be income-qualified (in receipt of economic support or ineligible for economic support as a result of income received under the *Old Age Security Act*) or have served overseas during a time of war. However, there are many other factors that can affect a veteran’s eligibility for health benefits. Exhibit 12.7 summarizes the key eligibility

requirements for each of the major health care benefits provided by Veterans Affairs.

Satisfactory controls over eligibility

12.50 The Department has established several control procedures to ensure that those who receive health care benefits are eligible for such benefits. Since 1991–92, the Department has been regularly reviewing a sample of treatment and drug benefits to ensure that recipients are eligible for and entitled to the benefits received. The use of sampling procedures is based on a 1989 Treasury Board policy that supports the use of statistical sampling to control payments. In developing a sampling plan, the Department has defined critical errors, assessed the risk of errors as low and established a maximum tolerable error rate of four percent that is consistent with the Treasury Board policy.

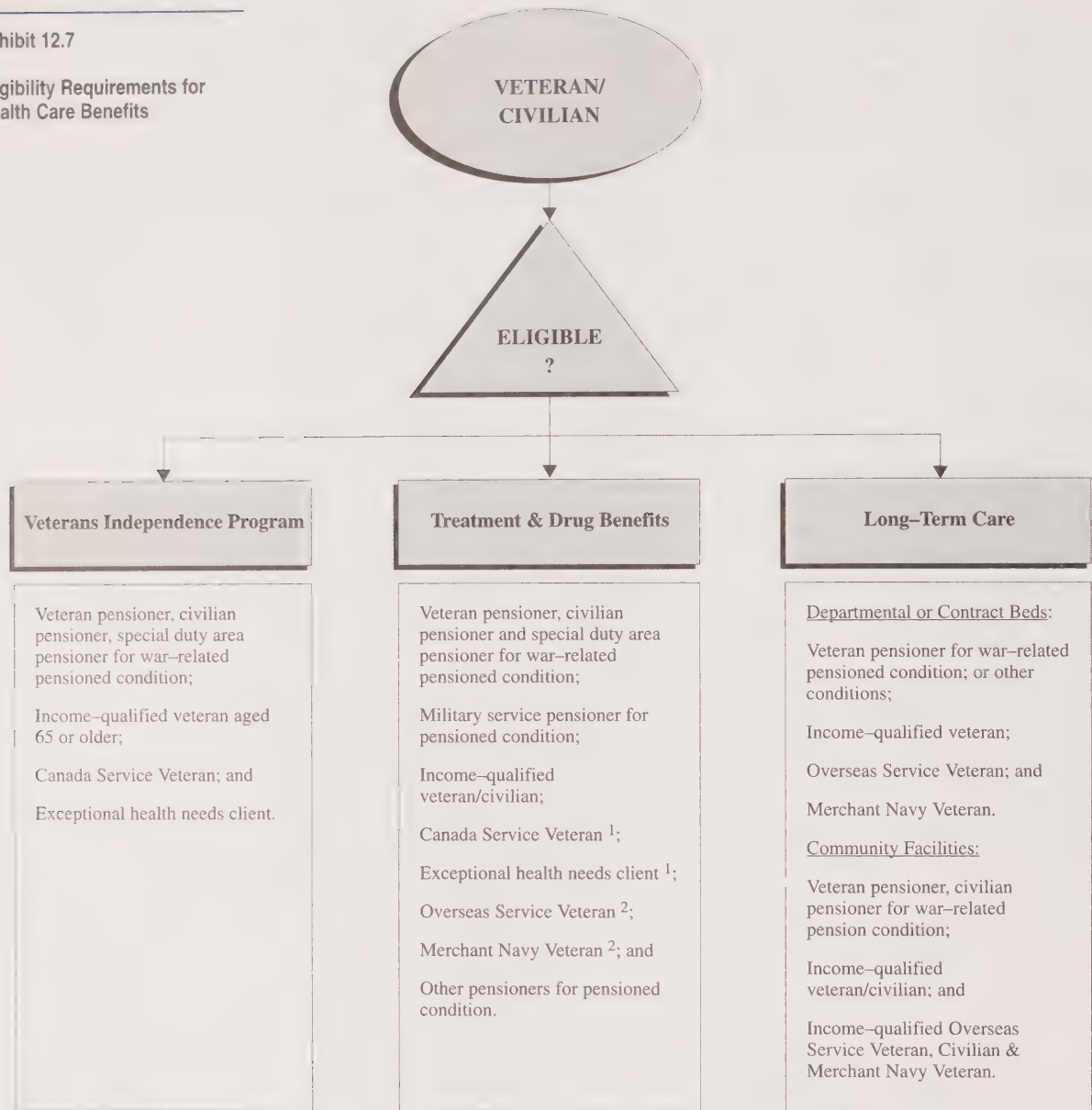
12.51 As part of our audit, we selected a sample of payments made during 1994–95 from the treatment and drug and Veterans Independence Program elements of the health care program to ensure that these benefits were paid only to recipients who met the basic eligibility requirements such as war service, age and annual income. We examined the supporting documentation to ensure that recipients were veterans who met income qualifications (income-qualified recipient), where applicable. We did not examine the impact of the jurisdictional issue on this sample. We found that the Department has satisfactory controls for determining eligibility and that only two percent of our sample were not fully entitled to the benefits received. This error rate is consistent with the Department’s results and within the error rate suggested by the Treasury Board policy.

12.52 In addition to the post-payment verification controls, income-qualified recipients who do not receive benefits

**In our opinion,
controls over eligibility
are satisfactory.**

Exhibit 12.7

Eligibility Requirements for
Health Care Benefits



1. If receiving VIP
2. If receiving long-term care benefits

Source: Veterans Health Care Regulations

under the *Old Age Security Act* are required to complete a statement of income each year. The Department regularly matches income information obtained from the recipient against income information from Human Resources Development Canada and Revenue Canada Taxation.

12.53 Income-qualified recipients who receive benefits under the *Old Age Security Act* are not required to complete a statement of income except upon application for benefits. We noted that in 1993 the Department implemented a system to ensure that recipients remain income-qualified for Veterans Affairs health care programs. The Department receives income information from Human Resources Development Canada and Revenue Canada Taxation on an annual basis. When the system was initially implemented in January 1993, 9,600 clients were identified as ineligible and had their benefits cancelled. Approximately 2,500 additional clients had benefits cancelled in 1994 and 1995.

12.54 After assessing the basic eligibility of potential recipients, the Department must determine the level of benefits required to meet client needs and the extent to which those needs are the responsibility of the federal government. We examined the Department's management of individual benefits entitlement and report our findings in the next three sections.

Long-Term Care

Background

12.55 The Department's role in the provision of institutional care has changed over time from that of direct service delivery to that of purchaser of services for clients. The Department meets the long-term care needs of eligible veterans

by providing 4,030 priority access beds either through contracts with non-departmental institutions or in its hospital at Ste. Anne de Bellevue. The Department is also responsible for paying the cost of long-term care provided to eligible veterans in community facilities. Exhibit 12.7 describes who is eligible for long-term care. Exhibit 12.8 shows priority access beds by province, the Department's estimate of the number of veteran clients as at 31 March 1996 residing in that province and the trend in long-term care expenditures from 1987 to 1996.

12.56 The audit examined how the Department:

- negotiated the cost of services provided under agreements with non-departmental institutions;
- monitored and reviewed the cost of services purchased;
- ensured that services of appropriate quality were received; and
- determined the number and location of its priority access beds.

12.57 The audit did not include an operational review of the departmental hospital at Ste. Anne de Bellevue because preliminary discussions regarding the transfer of this facility have started.

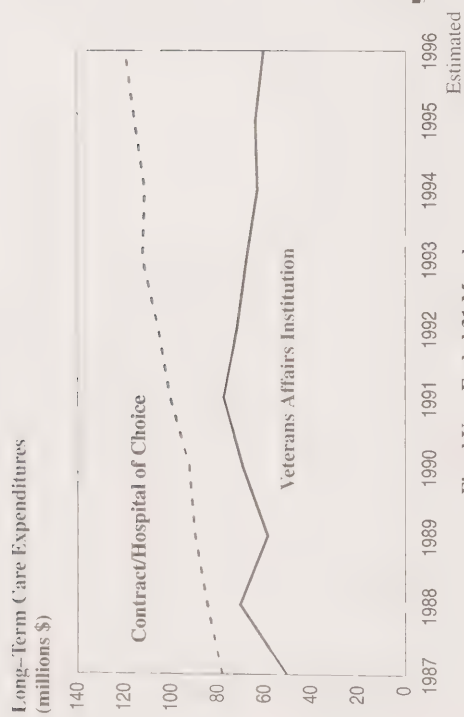
Weak controls over cost of service provided under agreements

12.58 The agreements between the Department and a facility form the basic contract for services delivered. We found that in certain instances there was no operating agreement in place and, in others, the operating agreements did not specify the level and quality of service that the Department was purchasing. While we recognize the different needs of recipients and the differences in provincial health care, we expected to see a standard

Exhibit 12.8

Priority Access Beds and
Veteran Clients by Province,
as at 31 March 1996

*Veteran clients are "service eligible
veterans" in pay at Veterans Affairs
Canada (excluding Canada Service
Veterans) and overseas service veterans.*



Fiscal Year Ended 31 March

Source: 1986-87 to 1995-96 Estimates - Part III



Source: Veterans Affairs Canada Corporate Planning Division

set of services to be purchased by the Department. This approach would give the Department more opportunity to compare the quality and cost of care among the facilities with which it has contracts.

12.59 The Department's operating practices for controlling the cost of services varied from one facility to another. However, two key control mechanisms for controlling the cost of service of a facility were the annual budget approval process, where Veterans Affairs paid the cost of a portion of a facility, and the subsequent operating review to ensure financial compliance.

12.60 We found that in many instances the Department did not require facilities to provide operating budgets for approval prior to the beginning of each fiscal year. There were examples where budgets were submitted six months into the fiscal year. In addition, we found several instances where the Department's operating review of a facility was conducted years after the fiscal period was completed. There is a backlog of operating reviews to be conducted.

12.61 We noted wide variations in the cost per patient-day paid by Veterans Affairs to facilities. The average costs per patient-day varied within regions as well as among regions, ranging from \$138 to \$234 for similar levels of care. The Department has not analyzed the reasons for the differences or used lower rates as a basis for negotiating costs with more expensive facilities.

National guidelines for quality of care need to be implemented

12.62 In 1990, the Department undertook an evaluation of its institutional care program. As a result of this work, a set of minimum standards known as the Core Program was developed to define the

expected level and quality of care to be provided to clients. However, the Core Program was not officially adopted or implemented. The implementation of national guidelines to establish the services the Department expects to be provided to patients, in both departmental and non-departmental institutions, would assist management in the rate negotiation process and facilitate the comparison of per diem costs among facilities.

12.63 We found that the Department's monitoring practices varied widely among regional offices. Variations included the number of visits to facilities by Veterans Affairs personnel, the use of tools such as guidelines or questionnaires to assess the quality of care, the use of monitoring reports prepared by the facilities and the extent to which departmental staff took an active approach to monitoring the quality of care in facilities.

Planning for priority access beds needs to be reviewed

12.64 In 1986, we noted that "the Department has not yet established the extent of its liability for provision of institutional care." We also noted that "it [the Department] needs to know what its part will be in ensuring that there are enough beds for the growing needs of veterans." In 1988, the Department conducted a bed study that identified the need for 615 additional institutional beds, most of which were subsequently acquired. Since then there has been a major shift in long-term care in Canada, away from institutional care to home and community care. In light of this shift, implementation of the Veterans Independence Program (intended to delay entry to institutions), expected changes in the future needs of the Department's aging client base and the forecast of potential future clients, Veterans Affairs needs to

Hospital budgets were submitted six months into the fiscal year.

There is a backlog of operating reviews to be conducted.

The Department has developed, but not implemented, national guidelines for long-term care.

re-examine its planning for priority access beds.

12.65 Veterans Affairs should improve management controls over the provision of long-term care, including:

- specifying the level and quality of service it expects;
- negotiating rates and budgets prior to the beginning of the fiscal year;
- regularly monitoring and reviewing compliance with financial and quality requirements of agreements with facilities; and
- reviewing its planning for long-term priority access beds.

Department's response: The Department agrees that controls over expenditures for long-term beds is an area requiring priority attention, and has already taken action to review its forecasting of bed needs for the next 10–15 years. The Department also agrees that there is a need for an enhanced framework for

quality assurance in its institutional care program.

Veterans Independence Program

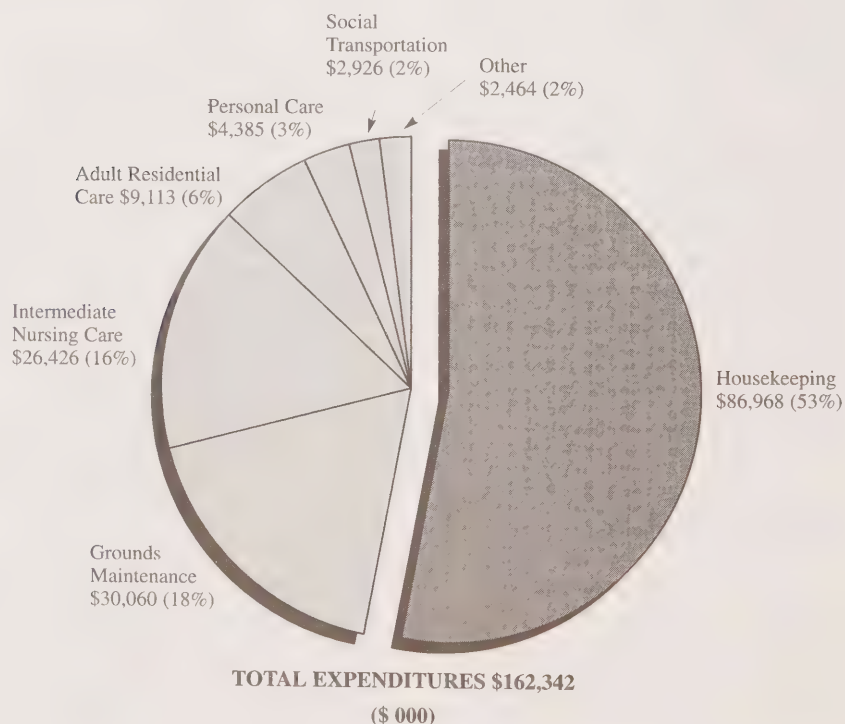
Background

12.66 In 1994–95, the Veterans Independence Program (VIP) provided benefits to 83,000 recipients to help them maintain healthy and independent lives in their homes and communities. Exhibit 12.9 shows the services covered by the Program and the 1994–95 expenditure for each service. In 1994–95, the average yearly payment under the Program was about \$1,950. Exhibit 12.10 shows the trend in VIP expenditures since the inception of the Program in 1986–87. As shown in Exhibit 12.7, entitlement to VIP benefits is also a means of becoming eligible for other health care benefits. Consequently, relatively small Program contributions can lead to much higher costs in terms of overall treatment and drug benefits.

Exhibit 12.9

Veterans Independence Program Services and Expenditures in 1994–95

These are typical percentages for the last three fiscal years with the exception of Intermediate Nursing Care (INC) and Adult Residential Care (ARC). Together, these two services have been 21% of the total expenditures. In the last three years the percentage of ARC has decreased from 12% to 6% while the percentage of INC has increased from 11% to 16%. This is caused by the discontinuation of ARC for new applicants in 1993–94.



Source: 1994–95 Departmental Reporting System

Contribution arrangements are weak

12.67 Each recipient of Veterans Independence Program benefits signs a contribution agreement with the Department. However, we found that it does not provide a strong control to ensure that the contribution will be spent as intended. For example, recipients are not required to acknowledge that funding is for specific purposes. Without a written acknowledgment of the conditions, the Department may not be able to ensure that contributions are spent as intended.

Implementation of advance payment has not met Treasury Board conditions

12.68 In June 1992, the Treasury Board gave the Department the authority to provide recipients with advance payments to cover housekeeping, grounds maintenance, transportation, personal care and nutritional services. Such payments could be made on a regular basis without the presentation of receipts. However, recipients were required to maintain receipts for inspection by a Veterans Affairs official upon request. As part of the approval process, the Department committed itself to maintaining a

previously implemented post-payment verification process based on financial risk considerations, and to continuing a comprehensive health needs assessment process.

12.69 The Department continued to perform regular post-payment verification of payments that were reimbursed, based on receipts. However, for clients receiving advance payments, the Department did not perform complete post-payment verification and review, on a national basis, from September 1992 until November 1995. During this period, the Department did not have procedures in place that dealt with the changing requirements of the advance payment system. For this reason, the Department stopped issuing quarterly reports on the results of its testing.

12.70 In January 1994, the Department completed a "VIP Post-Payment Verification Pilot" to develop procedures for advance payment reviews. Three hundred and twenty-six clients, who received advance payments during the six-month period after implementation, were requested to forward their receipts to the Department for review. Ten percent of

Post-payment verification was not fully implemented for advance payments.

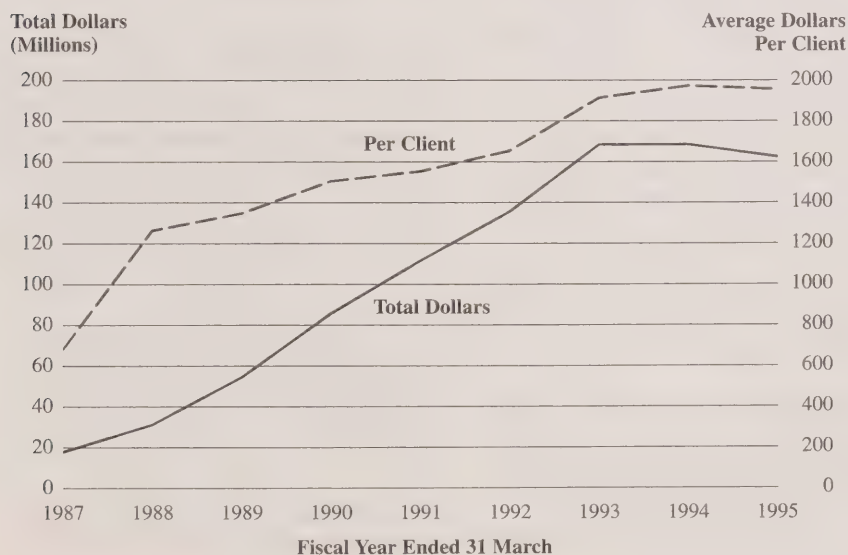


Exhibit 12.10

**Veterans Independence Program
Expenditure Trends 1987 – 1995**

Source: 1986–87 to 1995–96
Estimates – Part III

The link between health needs and services provided requires improvement.

these clients did not produce receipts and an additional 27 percent did not provide receipts for over one quarter of the advance payments received.

12.71 Controls for advance payments varied among the regions. In most regions, area counsellors conducted a cursory review of receipts when contribution arrangements were renewed. We found no evidence of such reviews in the limited sample of VIP files that we audited. The Quebec and Pacific regions conducted post-payment verifications of advance payments. The Quebec region found that 40 percent of the 120 clients contacted did not keep all of their receipts. The Pacific region found that 17 percent of 130 clients did not have adequate documentation. Departmental officials believe that these error rates and the one from the pilot project overstate the real error rate, because the definition of error was not adjusted for changes resulting from implementation of advance payments. The Department has indicated that the results of these reviews were used to develop improved controls for the advance payment system.

12.72 Approximately one half of the 83,000 Veterans Independence Program clients are in receipt of advance payments. For the advance payment files in our sample, we were unable to determine if the Department had adequate assurance that contributions were spent as intended under signed agreements with recipients. At the time of our audit, there was no evidence that departmental officials had examined the supporting receipts for these sample items.

12.73 In November 1995, the Department selected a national sample of Veterans Independence Program payments for post-payment verification review but, at the time of completion of our audit field

work in January 1996, the review of this sample had not been completed.

12.74 In 1995, the Department's Audit and Evaluation Division conducted a review of the Veterans Independence Program. As part of the review, the Division used a panel of health care experts to evaluate more than 300 health care needs assessments. The panel found that there was variability in the quality and quantity of information on assessment forms. Also, some assessments were not completed as specified by the program policy, and examples were noted where unmet client needs had not been identified. Our audit of a limited sample of VIP files supports the conclusions reached by the Department's review of the program.

12.75 We noted that the Department requires annual contact with each VIP client. With the limited resources available to the Department, the effect of this policy is that clients at all risk levels receive the same level of attention. The Department is currently conducting a pilot project that links the level of attention to the health care risk for each client. This approach could offer improved efficiency and better-quality service.

Program effectiveness not fully assessed

12.76 The terms of reference establishing the 1995 departmental review of the Veterans Independence Program described the purpose as assessing the Program's impacts and effects, evaluating the success of the Program and identifying opportunities to improve cost effectiveness and program management. However, after the terms of reference were established, the review team recognized that there were limited data available to empirically measure the Program's success. The review, therefore, relied on the quality of assessments and

care planning as proxy indicators of success.

12.77 Our audit noted that the review addressed issues related to the relevance of the Program and identified areas where the cost effectiveness and management of the Program could be improved. The expert panel concluded that the Program was relevant to the needs of clients and will become more so. The panel also concluded that, although in the majority of cases the type and level of services were appropriate, improved case management and documentation were needed to improve effectiveness. While the review noted that veterans are institutionalized at significantly earlier ages than non-veterans, a statistical study done as part of the review suggested that the Program's home care element could be delaying institutionalization by about two years.

12.78 Departmental officials believe that the Program has been effective in meeting its objectives. However, the Department does not have adequate empirical data to demonstrate the Program's impact on recipients' health or on helping recipients live independently in their homes and communities.

12.79 Veterans Affairs should improve controls for the Veterans Independence Program by implementing complete post-payment verification of advance payments and strengthening health care needs assessments, as recommended by the departmental review.

Department's response: Ongoing post-payment verification for advance payments has been implemented. Results of the first review sample are expected in mid 1996.

The Department is looking at enhancing its annual reviews to better identify health

care needs before they become serious and costly, and at enhancing its case management of clients with compounded health and social needs.

12.80 Veterans Affairs should gather adequate empirical evidence to demonstrate the success of the Program in achieving its objectives and the impact on recipients' health.

Department's response: The Department agrees with the need to regularly assess the Program's effectiveness, and has collected empirical evidence through surveys and interviews, statistical reviews and cost-benefit analyses, in addition to generating indirect supporting data. Several reliable, macro-level indicators do exist and support the claimed success of the Program, including evidence that since its initiation the average age of veteran clients being admitted for institutional care is rising steadily. This indicates that the veterans are remaining independent in their own homes for longer periods. Nevertheless, the Department is prepared to consider the use of other methods, such as longitudinal studies and self-reporting techniques, as long as they are cost-effective, non-invasive and objective.

Treatment and Drug Benefits

Background

12.81 Eligible veterans, as described in Exhibit 12.7, are entitled to a variety of treatment and drug benefits. These benefits and related expenditures in 1994-95 are summarized in Exhibit 12.11.

12.82 Exhibit 12.12 shows the trend in treatment and drug benefit expenditures since our last audit in 1986.

12.83 Drugs, treatment and medical devices are generally provided to eligible recipients by suppliers such as pharmacists, dentists, audiologists and optometrists. In order to ensure

Program effectiveness has not been fully assessed.

Improved controls over non-drug services have reduced costs.

cost-effective control over the services provided by these suppliers, most public and private sector medical plans have instituted controls for use and price. These controls usually include limits on the number of times a service can be used in a period (for example, eye glasses once every two years), limits on the type and number of drugs for which reimbursement will be made, requirements to use generic equivalents, monitoring of use to detect unusual patterns and preauthorization for certain services. Veterans Affairs has a contract with a private sector health insurer to deliver treatment and drug benefits. We examined the extent to which the Department has implemented controls to ensure cost-effective delivery of drug and treatment benefits.

Controls implemented for all non-drug services

12.84 In October 1994, Veterans Affairs implemented new controls for the provision of dental care. These controls included the establishment of a limit on the dollar amounts that must be preauthorized before treatment is provided, annual dollar limits per patient and a detailed list of approved treatments.

After years of steady increases, the cost of dental care dropped from \$28.9 million in 1993-94 to \$26.4 million in 1994-95 (8.7 percent). The Department has continued to experience cost savings in 1995-96. Departmental officials have found no evidence to indicate that the quality of care has suffered under these new controls.

12.85 Effective December 1995, Veterans Affairs introduced revised dollar and frequency-of-use limits as well as preauthorization for costly items for all other treatment benefits except drugs. We found that these new controls are comparable to those of other public and private sector plans. We also noted that exceptions can be made to meet the individual needs of recipients.

Improved controls for drugs are planned

12.86 At the time of our audit, the Department's drug formulary (list of covered medications) provided coverage for some 18,000 drugs. Most public and private medical care programs in Canada cover approximately 6,000 drugs. The Department's formulary coverage is the result of the combination of numerous

Exhibit 12.11

Treatment and Drug Benefits Services and Expenditures in 1994-95

Program of Choice	(\$000)	%
Prescription Drugs	72,862	42.1
Dental Services	26,364	15.2
Audio Services	17,838	10.3
Special Equipment	10,122	5.9
Oxygen Services	8,024	4.6
Vision Care	7,216	4.2
Hospital Services	6,945	4.0
Prosthetics and Orthotics	6,066	3.5
Related Health Services	5,268	3.0
Medical Supplies	4,138	2.4
Nursing Services	3,719	2.1
Aids for Daily Living	2,499	1.4
Ambulance Services	1,642	1.0
Medical Services	425	0.3
Total Treatment and Drug Benefits	173,128	100.0

Source : Veterans Affairs Canada
Treatment Accounts Processing System

regional formularies into a national formulary, as well as the practice of making all drugs generally available even if only one client had a need. The Department is in the process of revising its formulary to provide coverage through a standard formulary that will contain a reduced number of items. However, items to meet client needs that are not included in the standard formulary will be available in a special formulary that will require preauthorization on an individual basis.

12.87 Research indicates that elderly populations are particularly at risk for overmedication and inappropriate drug use. Many Canadian jurisdictions and health care plans are implementing procedures to monitor drug use and better manage health care. This monitoring has a number of benefits including cost containment, detection of overuse of medication and detection of unsafe drug interactions. In general, although the Department has such information available, its monitoring program has been limited to procedures that focus on potential errors or abuse. However, we noted the Department's Pacific region has established a treatment and drug benefit

review committee whose objective is to better manage and control the treatment and drug benefits in the region.

12.88 As part of the introduction of changes to the drug formulary, the Department plans to move to "real-time" control over drug purchases through a system developed by its contractor. It is the intention of the Department to design a system that will adjudicate drug claims against an individual's approved drug benefits at the time of purchase. The proposed system will be designed to improve controls and monitoring of quality of care by identifying drug interactions or cases of overmedication.

12.89 While Veterans Affairs expects to implement the new drug formulary and real-time adjudication in 1997, it had not developed a firm implementation date, a plan or budget at the time of our audit.

12.90 The Department has estimated that the new monitoring system and revised drug formulary will reduce drug costs by approximately 10 percent or \$7 million annually. In addition, the Department believes that monitoring of drug use will provide better quality of

The Department intends to improve controls for drugs.

\$ Millions

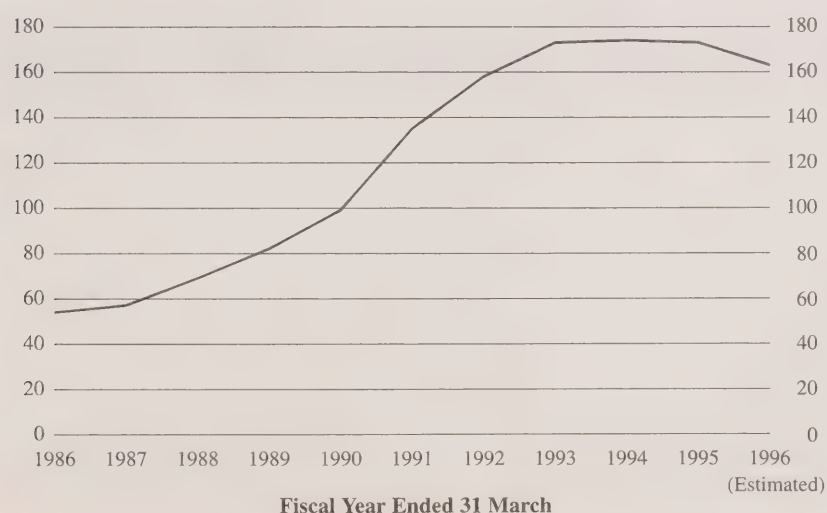


Exhibit 12.12

**Treatment and Drug Benefits
Expenditure Trends 1986 – 1996**

Source: 1985–86 to 1995–96
Estimates – Part III; 1994–95
Departmental Reporting System

The Department is paying dispensing fees for over-the-counter medications.

care. We are concerned that delays in implementing the new approach may delay receipt of the benefits.

12.91 Veterans Affairs should develop and implement a plan to realize the benefits of the revised drug formulary and improved drug-monitoring system.

Department's response: Work is under way on revisions to both the drug formulary and drug-monitoring system. Implementation is set for 1997.

The method of controlling over-the-counter medications is costly

12.92 We noted that the Department is paying for many over-the-counter medications that ordinarily do not require a doctor's prescription. In 1994-95, the Department estimated that approximately \$15 million was spent for such medications. In order to control access, the Department requires that these medications be acquired by means of a prescription. Therefore, the Department is

paying for dispensing fees for these common remedies. In some cases, the dispensing fees are greater than the retail price of the medication. On average, dispensing fees account for about 30 percent of the total cost of these medications. Also, in most cases, the health care system must bear the cost of a physician preparing a prescription so that clients can obtain these medications. Exhibit 12.13 provides examples of the dispensing fees and cost for common over-the-counter items covered by Veterans Affairs.

12.93 We believe that the Department needs to explore less costly alternatives to the current method of providing over-the-counter medications. For example, it could provide individuals with an annual discretionary limit that could be billed directly to the Department. Another alternative may be to negotiate an annual handling fee with pharmacists to provide these medications.

Exhibit 12.13

Cost and Dispensing Fees for Common Over-the-Counter Medications

Over-the-Counter Drug	Dispensing Fees *	Ingredient Cost*	Cost to Veterans Affairs*	Retail Cost at Pharmacy**	Total Cost 1994-95
Common liquid heartburn medication (600 ml)	\$ 4.43	\$ 10.52	\$ 14.95	\$ 10.79	\$ 56,777.00
Common tablet heartburn medication (100 tablets)	\$ 4.24	\$ 10.36	\$ 14.60	\$ 10.79	\$ 156,575.00
Coated acetylsalicylic acid (ASA) (100 tablets)	\$ 7.13	\$ 4.16	\$ 11.29	\$ 7.00	\$ 134,792.00

* These are the national average costs based on the summary of information for each purchase of the drug. The individual drug purchase information was provided by Veterans Affairs Canada.

** The common heartburn medication is dispensed to the veteran in the size or quantity that is found on a pharmacy shelf. However, in most cases the coated ASA is dispensed in quantities of 30 tablets (one month supply). The coated ASA is not found on pharmacy shelves in 30 tablet size so the comparison made in the analysis is the cost to Veterans Affairs Canada of dispensing 100 tablets versus the cost of a 100 tablet bottle found on the shelf.

12.94 Veterans Affairs should explore less costly means of providing over-the-counter medication to its clients.

Department's response: The Department agrees that the current means could be costly, and will examine alternatives, considering feasibility and with an eye to implementation, along with the revised drug formulary and monitoring framework.

- The Department requires more knowledge about the number and needs of its future clients and must complete its plan to meet those needs.

- Better cost-control measures need to be implemented for the key health care program elements.

- The expected quality of care needs to be better defined and monitored.

- More effective partnerships with provincial governments and other providers need to be developed.

- The Department needs to hold the providers more accountable for the level, appropriateness, outcomes and cost of service provided.

Conclusion on Health Care

12.95 Overall, high-quality health care benefits are provided to the Department's clients. There are a number of factors that make the health care provided by Veterans Affairs vulnerable to future cost increases:



About the Audit

Scope

Our audit focussed primarily on the Department's delivery of health care to veterans and other eligible clients. This function has been the fastest growing area of expenditure in the Department and, with the projected aging of the Department's client population, it is anticipated that the health care needs of these clients will continue to rise.

We also examined changes in the pension process that came into force on 15 September 1995. Because of these major changes, we limited the scope of our audit to documenting concerns about the timeliness of the previous pension approval process and the targeted reduction in average approval time.

We did not audit the economic support program because significant decreases in the size of this program are expected to continue over the next few years.

Objectives

Our objectives in auditing the health care program were to assess:

- how the Department identifies and plans to meet the health care needs of veterans;
- the Department's management of jurisdictional issues with provinces;
- the Department's procedures for ensuring that clients have received only those health care benefits to which they are entitled; and
- if the Department is acquiring long-term care, treatment and other health services in a cost-effective manner.

Quantitative information. The quantitative information in this chapter has been drawn from various government sources indicated in the text. Unless otherwise indicated, this information has been checked for reasonableness but has not been audited.

Audit Team

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Report of the Auditor General of Canada to the House of Commons – 1996

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Report of the
**Auditor General
of Canada**
to the House of Commons

Chapter 13
Study of Accountability Practices
from the Perspective of First Nations

September 1996

**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 13
**Study of Accountability Practices
from the Perspective of First Nations**



September 1996

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Chapter 13

**Study of Accountability
Practices from the Perspective
of First Nations**

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Study of Accountability Practices from the Perspective of First Nations

Foreword

As the relationship between the federal government and First Nations evolves, the issue of accountability continues to present difficulties to all parties. We have discussed many of these issues in previous reports, concentrating on the difficulty that government departments have experienced fulfilling their accountability obligations. For example, in 1993 and 1994 we reported a lack of clarity in the authority and mandate for some programs. We have also reported on a lack of appropriate performance information and the impact on accountability.

This study represents a different approach to this topic on the part of the Office. It is not an audit and therefore it does not conclude against a specific set of criteria. We have used studies in the past to draw Parliament's attention to a variety of issues.

This study focusses on the perspectives of one set of the parties involved, the First Nations. It is aimed at improving our understanding and encouraging the pursuit of solutions. The Office intends to build on this understanding and to take into consideration the lessons learned for future audits and studies dealing with the relationship between First Nations and government.

The approach used was to capture the views of selected First Nations and to explore the basis for a common understanding of the issues. This approach required that we present not only the views of these First Nations on the accountability issues faced by their leaders and program managers but also, to provide as context, their views on the environment in which the relationship operates. This environment is highly politicized and contentious. The views on this broad framework (presented on shaded paper) are those of the participating First Nations and not necessarily those of the Office.



Study of Accountability Practices from the Perspective of First Nations

Assistant Auditor General: Maria Barrados

Responsible Auditor: Ronnie Campbell

Main Points

13.1 As the relationship between the federal government and First Nations evolves, the issue of accountability continues to present difficulties to all parties. In its accountability to Parliament, government is expected to report on activities undertaken and results achieved. This relationship often becomes more complicated where third parties are used to carry out activities for which government remains responsible.

13.2 This study focusses on the perspectives of one set of the parties in such a relationship, the First Nations. It is aimed at improving our understanding and encouraging the pursuit of solutions. The Office intends to build on this understanding and to take into consideration the lessons learned for future audits and studies dealing with the relationship between First Nations and government.

13.3 This study is based on interviews with nine First Nations and one Tribal Council that Indian and Northern Affairs Canada considered to be well managed. Although there is a broad legal framework that governs First Nations' dealings with the federal government, and First Nations have obligations to their own communities, the discussion focussed on First Nations' day-to-day interaction with government departments. Management practices of First Nations and of government that participants felt could be improved were discussed at length.

13.4 Participants recognized the importance of effective accountability and articulated a clear sense of essential accountability factors. For example, participants felt that it is essential that both First Nations and government have clear and commonly held objectives, that audit meet the needs of their communities as well as of government, and that the focus be on results as opposed to process. Taken together, these factors fit within most definitions of accountability. In an area as complex and contentious as this, it is encouraging to see that these First Nations hold views that appear, to some degree, to be consistent with such definitions.

13.5 However, participants strongly emphasized a two-way perspective as an essential ingredient of accountability. Much of what we heard spoke of accountability among partners or equals. Generally, accountability in government is viewed as a hierarchical relationship involving a delegator, who assigns responsibility to another — a delegate. It is evident that there is a significant difference between this concept and the one that participants felt would better suit their needs.

13.6 While participants felt the current situation was unsatisfactory, many were optimistic and felt that progress could be made. They recognized that both they and government officials work under difficult and uncertain circumstances. This study represents one step toward encouraging improved dialogue with government and First Nations as they develop practical approaches to strengthening and clarifying accountability relationships.

Introduction

An Evolving Relationship

13.7 The federal government allocates funds to First Nations for education, health, social services and economic development. Some government departments, such as Indian and Northern Affairs Canada, have evolved from direct service delivery to, increasingly, funding agencies. This has meant an increase in funds transferred to First Nations. Other government departments have begun to move in this direction also. Health Canada is currently discussing with First Nations the devolution of many of its current responsibilities. Ongoing discussion of self-government initiatives, combined with increased devolution of government programs, has led to the increased interest in the question of accountability.

13.8 The evolution of Indian and Northern Affairs from direct service delivery to funding agency can be seen as having taken place in three general stages. Until the late 1950s, the federal government delivered most programs and services to First Nations. By the late 1970s, First Nations were administering government programs and following program circulars detailing terms, conditions, processes and reporting requirements designed by Indian and Northern Affairs. By the late 1980s, new funding arrangements had been developed, including alternative funding (AFAs), comprehensive funding (CFAs), and self-government funding — each with different types of arrangements, delegation of responsibility, control and reporting. The situation in the 1990s continues to evolve, with increasing emphasis on program devolution and self-government initiatives.

13.9 Funding arrangements in the area of health have also evolved. Health Canada is progressing with the transfer of control of health services to Indians and Inuit. To date, over 100 agreements have been signed.

13.10 As this devolution has progressed, we have reported to Parliament the difficulty that government departments have experienced in fulfilling their accountability obligations. Our concern with accountability stems from our role as auditors providing assurance to Parliament that responsibilities conferred and moneys provided have been used properly and wisely.

13.11 In its accountability to Parliament, government is expected to report on activities undertaken and results achieved. Similarly, accountability relationships within government support the ministers' obligation to report to Parliament. These relationships often become more complicated where third parties are used to carry out activities for which government remains responsible. For example, First Nations are carrying out an increasing range of activities for which legislated authority and related responsibility remain with government.

13.12 As funding arrangements have changed, so too have accountability relationships. When federal departments were engaged in direct program delivery, they were accountable for the results achieved and the moneys spent. This accountability was to Parliament, through the respective minister. As moves were made to devolve responsibility to First Nations, efforts were also made to promote local accountability.

13.13 Considerable effort has been made by government to improve the funding agreements and reporting structures to better reflect this evolving relationship with First Nations. Yet

First Nations are carrying out an increasing range of activities for which legislated authority and related responsibility remain with government.

difficulties remain. This study represents a different approach on the part of the Office to addressing these long-standing issues. We conducted several audits that reported on government's role in this relationship. Subsequently, we attempted to describe the views of selected First Nations on their relationship with government. This work in turn has produced a discussion of factors that these First Nations believe are important in establishing and maintaining effective accountability.

Objectives and Scope

13.14 Our objectives were:

- to provide views of selected First Nations on the accountability relationship with government, including –
 - identifying important factors in the relationship,
 - discussing what they entail and why they are viewed as important, and
 - assessing how the relationship is working;
- to explore the basis for a common understanding of the issue, including whether a basis exists for a multipurpose accountability framework that meets the needs of First Nations, government and Parliament.

13.15 Canada's Aboriginal peoples are diverse in terms of culture, geography, socio-economic status and legal status. A study of this nature could not hope to obtain views that would be representative of all Aboriginal peoples.

13.16 In an effort to explore the views of Aboriginal peoples, we focussed largely on First Nations, thereby obtaining the views only of some status, on-reserve Indians. Our sample included nine First Nations and one Tribal Council

comprising several First Nations. It was not statistically based; however, it was sufficiently representative to be illustrative of First Nations that are considered well managed. The sample included First Nations from each region, with the exception of the Territories, and included small, large, isolated and urban communities. It was drawn from a list of 50 First Nations that Indian and Northern Affairs viewed as being well managed.

13.17 Our analysis was initially based on the views expressed by participants from these nine First Nations and one Tribal Council. We then formed a committee composed of participants from five of these organizations to provide advice on the presentation of the findings and on the context necessary to interpret the findings.

13.18 This study was intended to be exploratory in nature and to enhance understanding of this area. We see the study as a first step in encouraging dialogue with government and First Nations as they develop practical approaches to strengthening accountability relationships. A brief outline of the approach and methodology is contained at the end of the study in **About the Study**.

Context

13.19 Before discussing the findings, it is important to provide some context to these discussions. We encountered a range of emotions, which can affect how people view their current relationship with the federal government. In describing that relationship, some felt that it was also important to relate how that relationship had evolved. The picture painted of the past was not a pleasant one. People wanted us to know that they believe that today's relationships were not always built upon a history of trust, fairness, equality or justice.

13.20 Throughout all of our interviews, it was clear that people felt strongly that current funding levels were insufficient. Many people believed that the Crown was not fulfilling its obligations, including treaty obligations to First Nations. However, this was not the main area of discussion. Having made these points, people tended to move on and discuss today's relationships in a manner that was candid, pragmatic, constructive and focussed on the day-to-day responsibilities that they had as leaders in First Nations communities.

13.21 First Nations must deal with different aspects of accountability. There is a broad legal framework that governs their dealings with the federal government. There is also the day-to-day practice, in which government departments and individual First Nations seek to meet their objectives while meeting their respective obligations. For First Nations, these include obligations to meet requirements determined by government and also by their communities.

13.22 This broader framework includes existing legislation and continues to evolve through discussions on self-government and land claims settlements in addition to discussion among the parties on the interpretation of existing treaties. Much of this interaction takes place at a political level, and few issues are resolved quickly.

13.23 In this somewhat uncertain environment, managers in each party have had to develop workable practices that help them meet their respective obligations. Most of the discussion related to this study focussed on these management practices, and on areas that participants felt could be improved more quickly.

13.24 There was some general commentary, however, on the current framework and political environment. The following summary of participants' views on this broad framework provides a useful backdrop against which discussion on specific management practices can be better understood. These views, presented on shaded paper, are those of the participating First Nations and not necessarily those of the Office.

The Broad Framework

13.25 Participants stated that they believe the federal government has a set of obligations that flows from this broad legal framework. In their view, the federal government has a fiduciary responsibility toward First Nations that obligates the government, often through treaties, to provide many of the existing programs. It was recognized that these views are not always shared by government, which often views programs as having developed as a result of policy rather than from various existing obligations.

13.26 Participants in the study felt that the federal government's obligations to First Nations should not have been assumed by the provinces without proper consultation and consent. Concern was expressed that in cases where the federal government had entered into such arrangements, these arrangements were not sufficiently transparent. In some cases, First Nations were not sure exactly what had been agreed to, and felt very strongly about this. Although some accepted that they had to deal with the provinces on matters relating to the delivery of programs and services, there was reluctance to deal with provinces on a political level.

13.27 Some felt that Indian and Northern Affairs often had conflicting responsibilities — for protecting not only

In this somewhat uncertain environment, managers in each party have had to develop workable practices that help them meet their respective obligations.

These First Nations talked about the importance of accountability, not only to those who provide funding but also to those who are intended to benefit.

the interests of First Nations, but also the interests of the government of the day.

13.28 There was sensitivity to any form of accountability suggesting that First Nations are in any way subservient to government departments. Some thought that federal government transfers to First Nations represent a right, for which they are accountable to the community, but for which no accountability to the federal government is required. However, most participants recognized that Parliament has a role and requires information to fulfill that role.

13.29 There was a hope expressed by some that a relationship with Parliament would be maintained that would not require First Nations to report to government departments. There was also recognition that, with over 600 diverse First Nations, this would present practical difficulties. The form this relationship would ultimately take, or what the accountability implications would be, was not clear.

13.30 Some participants believe that funding arrangements in the future may look more and more like transfer payments and that these may be similar to those arrangements that provinces have with the federal government. However, provinces have Provincial Auditors General and it was not clear from our discussions who will audit these arrangements with First Nations and provide the interested parties (including Parliament) with the assurance they require.

13.31 It was also not clear how Parliament would know whether the quality of health, education or living conditions is improving in First Nations, especially if only attest audits of financial statements are required. However, participants appeared willing to explore

ways in which arrangements could be adapted to ensure that the needs of Parliament were met.

13.32 One topic that emerged in virtually all of our discussions was that of devolution. Devolution is currently a subject of political discussions between First Nations and the federal government. Participants believed that the degree of devolution and the pace with which it occurs will influence the form of and expectations for accountability.

Findings

Internal Accountability

13.33 An aspect of accountability that was discussed during the interviews was the relationship between a First Nation's Council and administration, and its membership. Although this was discussed briefly, the following summary indicates that these First Nations take this aspect seriously. They talked about the importance of accountability, not only to those who provide funding but also to those who are intended to benefit.

13.34 Most First Nations talked about the importance of good communication between the Council and membership. Council meetings were often described as open to membership, with individuals welcome to express opinions. One First Nation mentioned that at least 4 and as many as 14 meetings are held annually. The value of such meetings is illustrated by the following statement made by one manager:

Communication is important. Any changes to policy or procedures that the Council wants to make are put before the band membership.

13.35 Some special Council meetings are also set up to discuss specific topics

such as the approval of the budget and the financial audit. Annual audit reports are often made available to members at an annual meeting. One manager pointed out that a letter explaining the financial statements in non-accounting terms is sent to each member of the community.

13.36 In addition, some First Nations set up committees and consult the community at various stages of projects. One individual commented:

Economic development projects have boards of directors and management committees that include members of the community. This is to ensure that projects are carried out wisely and that community consensus is maintained.

13.37 A number of participants mentioned that getting community buy-in to the various programs and decisions was important. First Nations have to attain and maintain trust between those who deliver programs and those who are recipients. Individuals interviewed felt that once administrators could establish that they were credible and sincere, membership would make the effort to work with them. That is also seen as enhancing accountability between membership and the Council.

13.38 Overall, when internal accountability was discussed, it was mostly in terms of communication and interaction between Council and administration, and members of the community. However, these discussions in our interviews were brief and the larger part focussed on the relationship between the particular First Nation organization and government organizations.

Practices That Result from the Interaction of First Nations Organizations and Government

13.39 Mostly, our discussions focussed on the interaction between the First Nations organizations and federal government departments and agencies. Aspects of current practice that, in the opinion of the participants, could or should work better were discussed in some detail. Many of the factors identified fit comfortably in definitions or models of accountability. These factors are summarized below.

Clear objectives

13.40 Participants said that neither party has a good understanding of the other's objectives. They felt that programs designed by government don't necessarily reflect the needs of the community.

13.41 People saw this as a two-way issue. They felt that First Nations do not understand the objectives that government departments and agencies are working toward. At the same time, they thought that the objectives of individual First Nations were not well understood by government departments. It was the view of the participants that it is essential that both First Nations and government have, in a broad sense, clear and commonly held objectives.

13.42 Virtually all people felt it was necessary to have communities involved in identifying needs and to have programs designed accordingly. They thought that programs would be more relevant if this were the case. It was also felt that planning should start with the First Nations, who would identify and prioritize their needs. This would then feed into the government's planning process. One person stressed:

Planning should start with the First Nations and be based on

Participants said that neither party has a good understanding of the other's objectives.

Many people felt it was necessary to have communities involved in identifying needs and to have programs designed accordingly.

First Nations' needs and priorities. The plans should then go to the government for negotiation and be included in the government's planning process.

13.43 They felt that this approach would strengthen the link between the needs of the community and the design of the programs being delivered.

13.44 In one case, a First Nation program manager outlined to us the following characteristics of a well-organized program, stating that such a program would:

- *be run by Native people;*
- *be geared toward the needs of the community (this is key), with an effort made to determine community needs;*
- *involve networking and co-operation — a sense of working together rather than the babysitting approach; and*
- *have the funding known up front, so managers would not have to wait to find out the level of funding available.*

13.45 It was stressed that the community should be able not only to identify its needs but also to set its own priorities.

13.46 Most felt that each party's objectives not only were not well understood but were, in some cases, quite different. This was particularly the case with regard to devolution. The First Nations' objective was described as putting more control of programs and resources into the hands of First Nations.

13.47 However, there was a strong feeling that the government's objective in devolution was simply to reduce

expenditures and that, in effect, First Nations were "being set up to fail". This was often described as "dump and run". One individual stated:

The government has associated downsizing with devolution.

This sentiment was also felt by another, who said:

Downsizing, not delegation, has driven the government's actions.

13.48 Participants thought that it was important for objectives to be agreed upon by both parties at a broad level. They also saw a need, once objectives were established, for flexibility on how they were to be achieved.

Audit

13.49 Participants recognized the necessity of audit, but stressed that they saw room for improvement. Independent auditors, usually appointed by First Nations organizations, prepare audit reports to meet the requirements of government. However, participants felt that current reports provide information of limited value to the community.

13.50 Some were already taking steps on their own to try to provide more meaningful information to the community, including one manager who expressed:

The audit should be more than just a collection of statistics. For example, the audit should look at whether funds have been spent most advantageously.

13.51 Some saw the potential value of audit to the community — that there were benefits for the community in knowing more about how and where funds were being spent. One manager observed:

The Band Council wants to report to the members of the community. We see the annual audit and opinion as a step in the right direction. We are looking at reviewing the First Nation's operations from a value-for-money perspective.

13.52 In this case, we were told that the community was about to begin doing value-for-money audits in an effort to meet the demand to know not only where funds were spent but what it was getting in return. In this sense, audit was seen as a valuable accountability tool within the community.

Reporting

13.53 Participants generally felt that each party to this relationship requires the information necessary to carry out its respective role. However, they believed that the current reporting regime was of limited value to First Nations, and that the requirements to provide information to the government were onerous.

13.54 While accepting that the government wanted certain types of information, they did not understand why some information was necessary, or what was done with that information. People generally felt that these reports and audits served the needs of the federal government more than they served the needs of First Nations and their membership. One manager asserted:

I believe that no one understands the First Nations' financial statements. The First Nation had to send a letter to each member of the community to explain the financial statements in non-accounting terms.

13.55 There appear to be two reasons for the participants' dissatisfaction with the current approach. In part, there is a sense that the reporting requirements are imposed upon them. In addition, the accountability regime does not appear to provide information that enhances accountability between First Nations and their membership.

Transparency

13.56 There was recognition of the need for transparency in First Nations' dealings with government. However, as with other factors, they saw this as a two-way issue; they felt that both parties could benefit from improved transparency. One participant stated:

Government departments should be accountable to First Nations in terms of funding formulas and policies that dictate what they do and do not do. At present, this is not transparent, which makes it difficult for us to explain to our membership why some things cannot be done.

13.57 From their perspective, participants thought that decisions made by government departments should, where they affect First Nations, be more transparent.

Focus on results rather than process

13.58 Most of the participants saw First Nations as accountable both to their membership and to the government. However, they saw themselves as accountable to the membership for results, while accountable to government for process. Although they recognized the need for government to put in place some systems and procedures to support program delivery, they stressed the need

Audit was seen as a valuable accountability tool within the community.

It appears that the accountability regime does not provide information that enhances accountability between First Nations and their membership.

Participants stressed the need for less cumbersome processes and more emphasis on results.

for less cumbersome processes and more emphasis on results.

13.59 One person interviewed stressed:

We would like accountability, and it should be focussed on results.

Another stated:

All parties should agree on the results to be achieved. In accounting for results, both parties would measure whether objectives had been achieved.

Yet another person asserted:

We want to focus on results rather than rules. We want to improve results, rather than argue about changing the rules.

13.60 There was a feeling that accountability would be improved if there were an increased focus on results, in addition to a simplification of the processes required. These views were expressed about a number of programs, such as education and economic development.

Aligning responsibility and capacity

13.61 In order to be accountable for an activity, the party in question must have the capacity to conduct the activity. People felt that in order to effectively adjust the relationship through the devolution process, both parties need to ensure that the capacity is in place to meet these changing responsibilities.

13.62 Participants said that the authority to administer programs began to be devolved several years ago, and that they had begun to acquire the necessary skills. However, some felt that the devolution process had left them with

fewer resources than the government had used to administer these same programs.

13.63 They felt that they had to deliver the same service with fewer financial, human and physical resources. In addition, they felt that the transfer of responsibilities needed to be accompanied by training. Some mentioned that First Nations staff often had to learn on the job, without the benefit of training or guidance. The concern was raised that there is a need to maintain a balance between responsibility and resources available.

13.64 People saw a strong administrative capacity as a building block toward exercising greater responsibilities. They appeared to take this issue very seriously and many were continuing to try to improve their administrative capabilities. In many cases, they had encouraged employees to attain professional qualifications. Administrators and managers had obtained, or were in the process of obtaining, university degrees or professional accounting designations. Where these skills were not available within the community, they had been obtained through external hiring.

Toward a Common Understanding

13.65 Taken together, these factors fit within most definitions of accountability. In an area as complex and contentious as this, it is encouraging to see that these First Nations hold views that appear, to some degree, to be consistent with such definitions.

13.66 These First Nations recognize the importance of effective accountability, and have articulated a clear sense of the essential accountability factors. Yet the overall view of the participants is that, in practice, these factors are not working

The overall view of the participants is that, in practice, the factors discussed are not working well for them.

well for them. They feel that they don't sufficiently help First Nations meet their own accountability obligations.

13.67 One reason for this may be found, in part, through closer consideration of the views on these factors as they were described by the participants. In describing each of the factors, participants have strongly emphasized a two-way perspective as an essential ingredient. They see transparency, for example, as working both ways: government should be transparent to First Nations just as First Nations activities should be transparent to government. In the case of audit, they feel that audit reports need to be of value to First Nations and their membership as well as to government.

13.68 This emphasis was quite strong throughout all the discussions on all of the factors. It is not enough, they felt, for First Nations' objectives to be clear and understood by government; but government's objectives with regard to programming directed at First Nations should also be clear and understood.

13.69 In fact, the discussion on objectives seems to suggest something more than just sharing information: it suggests that there should be a common purpose shared by First Nations and government. This, in itself, sheds some light on how First Nations view not only elements of their relationship with government but the very relationship itself.

13.70 Much of what we heard spoke of accountability among partners or equals. There was considerable discussion about sharing information and, indeed, sharing objectives. There was a strong preference for an accountability framework that would be of equal value and benefit to each party.

13.71 However, accountability in government is usually viewed as a hierarchical concept. The existing framework, based on legislation, often suggests a superior and a subordinate, a delegator and a delegate.

13.72 It is evident that there is a significant difference between this concept and the one that participants felt would better suit their needs. The existing framework evolved in order to enhance accountability to Parliament as government grew in size and complexity. It was born from the practical needs of ministers to retain responsibility for a very large set of activities and therefore was based on delegation.

13.73 Participants told us that government did not invent accountability, and that it was practised by First Nations in their own way, prior to contact. Their concept of accountability originated, they said, from a need to build consensus, through broad participation and consultation. In many cases, participants told us that they continue to try to manage programs in this way.

Conclusion

13.74 Where differing perceptions and expectations exist, developing arrangements that satisfy all parties is not easy. This is particularly the case for First Nations where the broad framework that governs their dealings with government is being redefined through negotiations.

13.75 However, is this participatory or shared accountability of which the participants speak irreconcilable with what they find within government? Participants don't believe that it is. The discussion identifies a number of areas where participants' views suggested that there is a sense of importance that is common to both parties, and common

There was a strong preference for an accountability framework that would be of equal value and benefit to each party.

Where differing perceptions and expectations exist, developing arrangements that satisfy all parties is not easy.

language and concepts are beginning to emerge. This can be seen as an important first step, and a basis from which progress can be made.

13.76 As the creation of duplicate processes tends to be burdensome and expensive, participants think that there is room for incremental progress between individual First Nations and government through ensuring that existing processes and practices meet the needs of both parties.

13.77 For example, as agreements come up for renewal, participants think that those elements that work only for government could be adjusted such that they also support First Nations' obligations to their membership. Further, reporting requirements could be modified to meet the needs of each party. Program objectives could also be redesigned in order to ensure that they meet the needs and obligations of each party.

13.78 Opportunities for both parties to reach common solutions may increase, helped in part by changes currently taking place and affecting both parties. First Nations believe that they are continuing to strengthen their management and administrative capacity. Government continues to encourage public servants to improve services through innovative and creative changes to programming. In addition, government is now considering alternative partnership options for the delivery of various programs and examining different types of accountability structures such as horizontal or shared accountability structures.

13.79 Participants feel the current situation is unsatisfactory, yet many are optimistic, and feel that progress could be made. They recognize that both they and government officials work under difficult and uncertain circumstances. Some of the participants have already begun to take initiatives to improve their understanding of how government works, and what constraints officials currently face.

13.80 This study does not contain specific recommendations; instead it discusses the issues from the perspective of selected First Nations. The views presented suggest that, while differences remain, there is also room for encouragement. These First Nations were willing to discuss accountability and have expressed a desire to help make it work for all parties. This study represents one step toward encouraging improved dialogue with government and First Nations as they develop practical approaches to strengthening accountability relationships. The Office intends to build on the understanding gained from this study and take into consideration the lessons learned for future audits and studies dealing with the relationship between First Nations and government.

***Departmental comments:** Indian and Northern Affairs Canada finds the Auditor General's observations and the First Nations' views expressed in the study both encouraging and helpful. The Department looks forward to pursuing the dialogue with First Nations on practical approaches to be considered to strengthen our respective accountability regimes to our mutual benefit. The information presented in the study will assist the Department in pursuing discussions with First Nations.*

Opportunities for both parties to reach common solutions may increase, helped in part by changes currently taking place and affecting both parties.



About the Study

Objectives

Our objectives were:

- to provide views of selected First Nations on the accountability relationship with government, including –
 - identifying important factors in the relationship,
 - discussing what they entail and why they are viewed as important, and
 - assessing how the relationship is working;
- to explore the basis for a common understanding of the issue, including whether a basis exists for a multipurpose accountability framework that meets the needs of First Nations, government and Parliament.

Approach and Methodology

The following steps were taken to complete the study:

Preliminary work. An extensive literature review of material dealing with issues related to First Nations was conducted. Indian and Northern Affairs officials were interviewed with a view to having them identify well-managed First Nations organizations. An analysis of 50 First Nations organizations was completed by reviewing documentation on each organization and interviewing the Indian and Northern Affairs officials who interacted with these organizations.

Field work. The list of First Nations willing to participate in the study was finalized (a total of nine First Nations and one Tribal Council). This list included First Nations from each region except the Territories. It included more remote First Nations as well as those closer to urban centres, and smaller as well as larger First Nations. It also included First Nations that have different types of funding arrangements with government. The study team undertook field visits, which included extensive interviews with First Nations representatives, to obtain their perspectives on accountability issues. For most First Nations, discussions were with Chief and Council, in addition to First Nations administrators and program managers. The interviews were always conducted by at least two members of the study team and were designed to be open-ended because the team's objective was to obtain participants' opinions on accountability issues. The participants were encouraged to discuss a broad range of issues with regard to their relationship with the federal government.

Analysis. Consolidated interview notes and a list of factors affecting accountability were developed for each First Nation. Confirmation that these factors represented an accurate account of the discussion was sought from the participants. Detailed analyses based on the interview notes, lists of factors affecting accountability, observations from the field visits, and documentation provided by the First Nations were undertaken. A draft report, summarizing the findings, was completed.

Reporting. A working group, made up of participants from five of the organizations, was formed to provide extensive comments on successive study drafts. As well, participants from these five organizations attended a one-day workshop with the Auditor General and the study team to discuss the contents of the study report. Concurrence on the final report was obtained from these First Nations.

Study Team

Sylvie Cantin
Glenn Wheeler

For information, please contact Ronnie Campbell, the responsible auditor.

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Report of the
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to the House of Commons

Chapter 14
Service Quality

September 1996

**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 14
Service Quality



September 1996

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Chapter 14

Service Quality

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Service Quality

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Main Points

14.1 The federal government delivers many services directly to the public, ranging from issuing passports to answering tax enquiries, to processing claims for employment insurance. However, recent studies continue to show that Canadians remain generally dissatisfied with federal services.

14.2 Since 1990, the government has committed itself to establishing service standards and being accountable for the resulting performance. Service standards would clearly specify the quality of service Canadians can expect to receive, including its timeliness, accessibility and accuracy. An original goal of the government's was to have standards published for major services by March 1994 and to report performance in 1994–95. Later, the goal was extended to the end of 1995.

14.3 Our audit of 13 highly visible services revealed that the government's expectations have not been realized. As of 31 March 1996, although many of the 13 services had put in place some elements of the concept, none of them had implemented service standards that met all the requirements.

14.4 Information on clients' priorities is a prerequisite for developing sound service standards and improvement plans. Only about half the services we audited have collected information on client priorities and their relative importance. Even fewer have assessed their clients' satisfaction with the way each of their priorities is served. This knowledge is important; there is little point to investing effort in areas where client priority is low and satisfaction high when there may be a much better return in areas of high priority and low satisfaction. We also found that many services have not determined the full costs of delivering service. Cost information helps to ensure that government clients receive high-quality and affordable services.

14.5 Telephone services are a significant and growing method of contact between Canadians and the government — with more than 30 million calls answered per year in the six operations we examined. However, the quality of government telephone services needs attention. In one department we found that during peak periods as many as 19 out of 20 calls receive a busy signal. Few departments check the accuracy rate of information that agents give to callers — one that has done so found that the accuracy rate falls between 60 and 80 percent. We believe that departments could and should apply service standards to remedy these persistent problems.

14.6 Much in the area of service standards remains to be done, and a sustained effort is required. Deputy ministers need to provide leadership to ensure that departments focus sufficient effort on major services and follow appropriate plans in developing and implementing service standards. So far, little information has been provided to Parliament to indicate clearly the progress against implementation goals. The government needs to improve its reporting to Parliament on this important subject.

Introduction

Service standards to improve service to the public

14.7 The federal government delivers many services directly to the public, ranging from issuing passports to answering tax enquiries, to processing claims for employment insurance. However, recent studies continue to show that Canadians remain dissatisfied with federal services.

14.8 The government wants to improve its services through the use of client-oriented service standards that clearly specify the quality of service Canadians can expect to receive, including its timeliness, accessibility and accuracy. A client-oriented approach requires managers to consult clients about their needs and priorities, and to seek input from staff on ways to improve the delivery of service.

14.9 Client-oriented service requires looking at the entire delivery process from the client's point of view. This can lead to better, more efficient service because it provides insights to the problems that cause errors and rework. A focus on client priorities also helps managers, in times of shrinking budgets, to decide from a client's perspective what should be funded or cut back.

14.10 A client-oriented approach also promotes transparency and accountability. If clients have a clear idea of what they can expect, it is easier for them, in turn, to consider the reasonableness of their expectations. If staff are involved in setting standards, they will be more willing to be held accountable for actual performance. Companies in the private sector have found a strong correlation between client and employee satisfaction. If clients are happy, employees are likely to be more satisfied, and vice versa.

Public services oriented to clients and citizens

14.11 Of the full range of activities undertaken by the public service, some lend themselves more to client-oriented service standards than others. Government services are often categorized as follows:

- policy and legislative development functions;
- regulatory and enforcement activities; and
- conventional service delivery to Canadians.

14.12 Policy and legislative development is a complex function that has no direct counterpart in the private sector. A linkage exists, however, between policy and the direct service delivery activities of government. Regulatory and enforcement activities demand a complex range of considerations. Most notably, as these services generally impose constraints for the public good, the "client" focus must be broadly interpreted as a focus on citizens so that neither the public's perception nor that of specific target groups — for example, representatives of an industry being regulated — is ignored in evaluating the services provided.

14.13 Conventional service delivery most closely approximates private sector operations; these direct services lend themselves most closely to the private sector approach to service quality. For government, clients can be defined generally as Canadians who avail themselves of the services in question. We focussed our audit on high-volume services provided to Canadians by the federal government.

Public Service 2000 set the stage

14.14 In 1989, the federal government launched Public Service 2000 (PS 2000), an initiative to renew the public service. PS 2000 was designed to bring the public

The government wants to improve its services through the use of client-oriented service standards that clearly specify the quality of service Canadians can expect to receive.

**“Departments will have service standards in place for their major services by the end of 1995.”
(1995–96 Estimates, Part I)**

service into the 21st century in the face of various pressures, including fiscal restraints. It was aimed at developing innovative ways to encourage efficiency and to improve program delivery.

14.15 The Task Force on Service to the Public, one of the PS 2000 task forces, reported that:

- most departments had not enunciated formal levels of service;
- clients were not consulted to the extent required;
- the public service, with some exceptions, was not service-oriented;
- new technology was underused in comparison with the private sector; and
- service considerations tended to be secondary to administrative ones.

The Task Force recommended, among other actions, that the government develop a service-oriented culture and implement service standards.

14.16 The government’s 1990 white paper *The Renewal of the Public Service of*

Canada, which reflected the recommendations of PS 2000 task forces, included a commitment to “openness and consultation in providing services to the people of Canada.” The white paper committed deputy ministers to establish clear standards of service, and to be accountable for the reasonableness of those standards and the quality of service provided to the public. They were to ensure that information about client satisfaction and suggestions for improving service was regularly sought from both clients and employees, and were to establish simple procedures for responding to complaints. These commitments became known as the Service Standards Initiative.

14.17 Since 1990, the government has made a series of commitments to this Initiative. For example, in the 1995–96 Estimates, the government stated a commitment to ensuring that clients receive high-quality, affordable services that are accessible and responsive, and that balance the interests of taxpayers with those of service recipients. Some of the

Exhibit 14.1

Government Commitments toward Service Standards

Date	Document	Commitment
December 1990	The Renewal of the Public Service of Canada	“Deputy Ministers will establish clear standards of service, and will be accountable for the reasonableness of these standards and for the quality of service provided to the public.”
February 1992	The Budget and the Budget Plan	“Departments will now increasingly begin to develop and publish standards for service, based on consultation with clients, that clearly spell out service levels and costs.”
June 1992	Clerk of the Privy Council, <i>First Annual Report to the Prime Minister on The Public Service of Canada</i>	“Our first challenge for 1992...must be to deliver meaningful progress to Canadians in the area of service. This means...giving Canadians tangible proof of positive change, in order to maintain their continued support for public service renewal.”
February 1994	The Budget Plan	“The government will establish and publish by 1995 standards of services for each government department.”
February 1995	1995–96 Estimates, Part I	“Departments will have service standards in place for their major services by the end of 1995.”

other major commitments are summarized in Exhibit 14.1. Over the period when these commitments were being made, government departments were also being reorganized, budgets were being cut, the public service was being downsized and programs were being reviewed.

14.18 In late 1995, the government distributed to the public service its *Declaration of Quality Service Principles* (see Exhibit 14.2), reaffirming its commitment to the Service Standards Initiative.

Focus of our audit

14.19 The objective of our audit was to assess the government's progress in developing client-oriented service standards, and to review how departments are using performance information to improve service. We focussed on 13 highly visible services that are delivered directly to the public, such as customs inspection of travellers and social security benefits. The services we selected are typically used by Canadians at one time or another during their lives (see Exhibit 14.3). We examined two additional services — the Trade-mark Branch and Spectrum Management Operations, both of Industry Canada — because the progress they have made can provide valuable lessons for other federal departments. The results from our

examination of these two services are not included in our tabulations.

14.20 The 13 services we examined included a mix of telephone, mail, walk-in and even electronic access such as fax-back and computerized kiosk. As telephones have become the most frequently used method of contact between Canadians and their governments, we gave special attention to the telephone operations in six of the 13 selected services (see Exhibit 14.4).

14.21 Our findings reflect the situation as of 31 March 1996. Further details on our approach to the audit are presented at the end of the chapter in **About the Audit**.

Observations and Recommendations

Service Standards

14.22 The Service Standards Initiative is a centrally driven, government-wide initiative that requires service managers to establish service standards and be accountable for the resulting performance. The President of the Treasury Board was assigned overall responsibility for the initiative. The Secretary of the Treasury Board took a lead role in developing guidance, requesting progress reports and co-ordinating interdepartmental networks and committees. Deputy ministers, for their

The Government of Canada is committed to delivering quality services to Canadians. Our clients can expect to receive service that:

- is prompt, dependable and accurate;
- is courteous, and respects individual rights, dignity, privacy and safety;
- is good value for money, and is consolidated for improved access and client convenience;
- reflects a clear disclosure of applicable rules, decisions and regulations;
- respects the *Official Languages Act*;
- is regularly reviewed and measured against published service standards, and these reviews are communicated to clients; and
- is improved wherever possible, based on client suggestions, concerns and expectations.

Exhibit 14.2

Declaration of Quality Services Principles

Source: Treasury Board Secretariat, *Quality Services: An Overview*, October 1995, p.3

part, were required to report progress within their departments and, since 1992, have been required to include such reports in the departmental multi-year operational plans (now the business plans).

14.23 A committee on service standards, composed of assistant deputy ministers from line departments and representatives

of the Treasury Board Secretariat and the Office of the Comptroller General, was established in 1991 to provide guidance to departments on how to implement service standards. Each department designated a person to take on additional duties as a co-ordinator for service standards, reporting generally to an official at the

Exhibit 14.3

The 13 Frequently Used Services Audited

Department	Major Services	Service Outputs
Citizenship and Immigration Canada	Applying for Canadian citizenship	Citizenships granted 220,000
Foreign Affairs and International Trade Canada	Applying for a Canadian passport	Passports issued 1,398,000
Foreign Affairs and International Trade Canada	Obtaining consular services at a Canadian mission overseas	Canadians assisted 1.5 to 2 million
Public Works and Government Services Canada — Reference Canada	Calling the 1-800 number (in the Blue Pages) and asking how to contact specific government units	Enquiries answered 747,976
Revenue Canada — Customs	Going through customs inspection at an airport or a border crossing	Travellers processed: Airports 13.4 million Land crossings 87.9 million
Environment Canada	Getting weather information through telephone and other means	Public forecasts produced 500,000 Enquiries answered (mostly automated) 50 million
Canadian Heritage	Visiting Canadian national parks	Visitors to parks 4.9 million
Revenue Canada — Taxation	Enquiring about taxation matters at a counter or by telephone	Enquiries answered: Counter 2.4 million Telephone 8.2 million
Human Resources Development Canada	Applying for Employment Insurance benefits	Applications processed 3 million Payments made 27.2 million
Human Resources Development Canada	Applying for Old Age Security or Canada Pension Plan benefits in Income Security Program	Applications processed 2.5 million Payments made over 100 million
Royal Canadian Mounted Police	Obtaining police assistance in towns and villages served by the RCMP	Population served 6.4 million Number of calls for service 1.5 million
Industry Canada and Partners	Obtaining information from a Canada Business Service Centre	Enquiries answered 686,536
Statistics Canada	Obtaining statistical information at the local Reference Centres of Statistics Canada	Enquiries Answered: Telephone 460,000 Walk-in 28,000

Source: Data supplied by departments or provided in Part III of the Estimates

assistant deputy minister level. An Interdepartmental Quality Network was established in 1991 to serve as a forum and catalyst for discussions, with the aim of fostering quality management concepts and promoting quality of service. Other interdepartmental networks were also established, including those that later evolved into the Service Standards Network. All of these structures still exist.

14.24 In 1995 the Service Standards Initiative became part of the government's

newer Quality Services Initiative, but the basic concepts and requirements for service standards remained unchanged.

Government expectations have not been realized

14.25 In June 1993, the Secretary of the Treasury Board established a deadline for the implementation of service standards. The minimum expectation was that departments would have published service standards for all of their major services by the end of March 1994, and that they

Exhibit 14.4

The Six Telephone Operations Audited

Departments and Operations	No of Call Centres	Salary \$ ¹	Volume of Calls Answered		
			By Automated Systems	By Agents	TOTAL
Human Resources Development Canada Employment Insurance Info-Centres (1995-96)	24	14,702,000	13,087,254	6,108,546	19,195,800
Human Resources Development Canada Income Security Program Call Centres (1994-95)	17	6,836,769	statistics not available	2,907,612	2,907,612
Revenue Canada – Taxation General Enquiries ² (1995-96)	47	25,895,861	2,000,000 ³	6,169,135	8,169,135
Citizenship and Immigration Canada Telecentres (1994-95)	23	2,907,815 ³	663,552	450,000 ⁴	1,113,552
Public Works and Government Services Canada, Reference Canada Telecentre, National Capital Region (1995-96)	1	1,270,327 ⁵	does not have an automated voice response system	747,976 ⁶	747,976
Industry Canada and Partners Canada-Ontario Business Call Centre (1995-96)	1	856,380	114,353	82,618	196,971

Notes:

- Figures in this column should not be used for the purpose of calculating the cost per call, which may be affected by many other factors, such as average talk time and wrap-up time, that vary from department to department.
- Excluding centres that deal with Child Tax Benefits, and GST Credits and T1 Refunds.
- Approximate number.
- Approximate number. A study done for the Department suggested, based on information provided by the Toronto Telecentre, that only 15% of the calls that entered the system were connected to a Citizenship and Immigration Canada agent.
- This figure does not include salary costs for Quebec and Manitoba, where the program is delivered under separate federal-provincial agreements.
- This figure does not include call volumes in Quebec and Manitoba.

Source: Data supplied by departments

would publish performance measures against these standards in 1994–95. In February 1995, the government repeated its commitment in Part I of the 1995–96 Estimates, but extended the deadline for implementation (see Exhibit 14.1). It stated that departments would have service standards in place for their major services by the end of 1995.

14.26 In November 1995, in his annual report to Parliament, *Strengthening Government Review*, the President of the Treasury Board stated that he expected that most departments would have developed and published standards for their most important services by 31 March 1996.

14.27 However, our audit findings indicate that these government expectations have not been realized. Some of these major services are in the early stages of developing service standards, and much more needs to be done. The following sections set out our detailed findings about the government's progress in implementing service standards and about departments' use of performance information to improve service.

Implementation of service standards was incomplete for most services

14.28 According to the Treasury Board, service standards are to be communicated to clients and are to include a description of the service concerned, service pledges,

delivery targets, cost of service, and complaint and redress mechanisms. The Board also expects departments to report performance against these standards (see Exhibit 14.5).

14.29 Our findings indicate that, overall, the government's progress in implementing service standards has been slow and its achievements uneven. As of 31 March 1996, none of the 13 services had published service standards that contained all of the required elements. Most had published descriptions and many had made pledges to clients to provide good service. However, only a few had communicated delivery targets and publicized complaint mechanisms to clients. None had communicated performance against targets or costs of service to clients at points of service (see Exhibit 14.6).

14.30 Even leaving aside the requirement to publish, we found that implementation of service standards was still incomplete. Most services had delivery targets, but they were not necessarily based on consultation with clients. Only four services had made an effort to determine the full cost of service. In addition, many services had not developed the necessary systems and procedures to collect consistent and reliable performance data on service quality; nor had they sufficiently organized their complaint mechanisms as a means to improve service.

Exhibit 14.5

Key Elements of Service Standards

Source: *Service Standards — A Guide to the Initiative*, Treasury Board of Canada, 1995

- A description, which supplies details on the service and, if applicable, the benefits clients can expect to receive
- Pledges or statement of principles, which describe the quality of service a client can expect to receive, with emphasis on openness, fairness and courtesy
- Delivery targets, which describe the key aspects of the service delivery such as access, timeliness and accuracy
- Costs, which tell clients what the service costs, even when there are no user fees
- Complaint and redress mechanisms, which give clients a means to resolve their concerns when they feel the government has not met its promised service standards
- Performance against delivery targets, which is measured and reported

Delivery Targets

Information on clients' priorities is not systematically collected

14.31 To set meaningful delivery targets, departmental service managers need to determine what is important to clients. Information on clients' priorities is a prerequisite to developing sound service standards and improvement plans. A variety of mechanisms can be used to determine client needs and priorities, such as advisory panels, citizen boards, focus groups and formal surveys.

14.32 Government services have used various client feedback methods and with varying frequency. We noted several examples where the results of client consultation were used to change or improve service. However, only about half the services we audited have collected information on client priorities and their relative importance. Even fewer have assessed their clients' satisfaction with the way each of their priorities is being served. This knowledge is important; there is little point to investing effort in areas where

client priority is low and satisfaction high when there may be a much better return in areas of high priority and low satisfaction (see Exhibit 14.7). Such knowledge is also significant in supporting decisions to reduce or reallocate resources.

Many delivery targets but only a few communicated at points of service

14.33 Delivery targets are benchmarks against which the timeliness, accessibility, reliability and accuracy of services are to be measured. They are the most visible and often the most difficult component of service standards to develop and implement. Communicating delivery targets to clients at the point of service is the clearest sign of service managers' commitment to quality. In addition, setting delivery targets is a key management tool for assessing performance and improving service.

14.34 Most of the services we audited have developed some delivery targets. The few that have been communicated to clients tend to focus on timeliness. The Income Security Program promises its clients, in various program pamphlets

There is little point to investing effort in areas where client priority is low and satisfaction high when there may be a much better return in areas of high priority and low satisfaction.

Number of Services

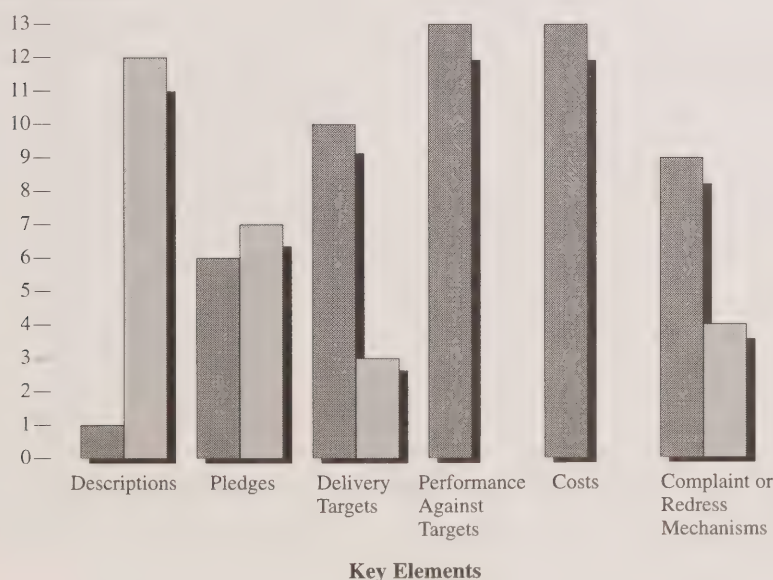


Exhibit 14.6

Communication of Service Standards at the Points of Service

Not Communicated
Communicated

Source: Tabulation based on OAG assessment, excluding Trade-mark Branch and Spectrum Management

Managers expressed concern that in a time of government downsizing they might be unable to meet the published service standards.

available at local offices, that they will get their benefit cheques in the last three banking days of each month. The Passport Office has printed turnaround targets in its application forms: five days if the application is made in person and 10 days if made by mail. Consular Services makes turnaround targets available to clients, upon request. At the time of our audit, Employment Insurance had not yet posted its new national turnaround target of 28 days for first cheques, but a few local offices had posted their own standards.

14.35 Experience in both public and private sectors shows that service quality has a number of important dimensions: accessibility, timeliness, accuracy or reliability, courtesy and other tangible matters related to the service environment. The government’s “Declaration of Quality Services Principles” promotes these same attributes. We found that, in determining service standards, most services tended to focus on timeliness and accessibility. Accuracy was not as explicit a delivery

target, although often it was at least implied.

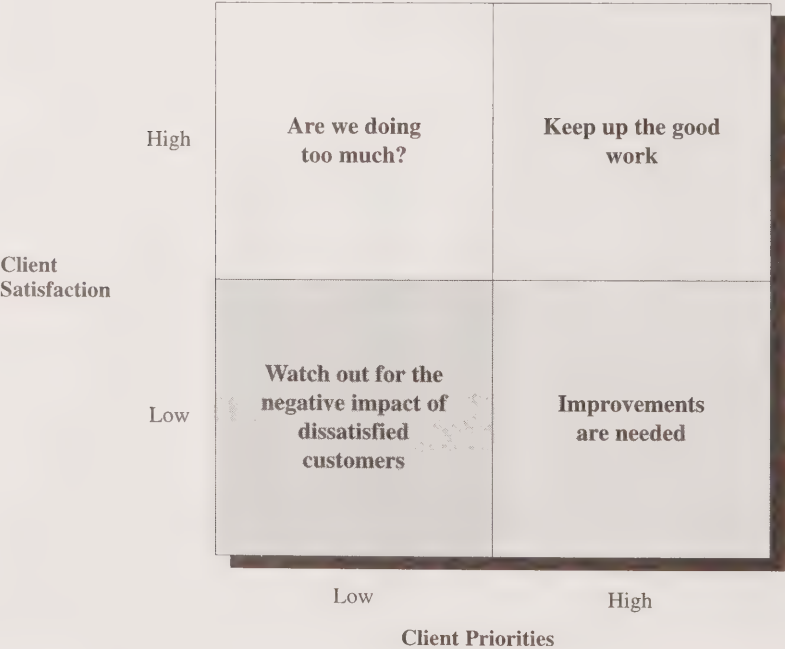
14.36 Service managers should ensure that delivery targets reflect client priorities.

Few incentives to publish delivery targets

14.37 Delivery targets are expected to be challenging but attainable. Managers saw little incentive for communicating delivery targets to clients. For example, they expressed concerns that in a time of government downsizing they might be unable to meet the published delivery targets or to deal adequately with the resulting complaints, or they might want to first make improvements through re-engineering. Despite these concerns, the Trade-mark Branch has published its performance against standards, even though some stated targets have not been met (Exhibit 14.12, page 14–24).

14.38 In the United Kingdom, executive agencies that deliver services to the public have published standards as part of the

Exhibit 14.7
Service Performance Gap



Citizen's Charter Initiative. Their standards do not necessarily represent "perfect" service and are often expressed as a proportion of 100 percent. For example, processing agencies set targets for clearance times — that is, the time from initial receipt of an application to the issue of benefits — as a percentage of volume to be cleared within so many days. This allows for some forgiveness in the system, but also gives clients a notion of what to expect. Another U.K. agency set different standards for peak and non-peak periods to reflect realities of government service. In addition, targets are sometimes stated as aims, with a caveat for unforeseen circumstances.

14.39 Private sector organizations regard delivery targets as a key component of their service strategy. However, informing clients about the targets and about actual performance against them is not a common practice for many companies. In this regard, the governments of Canada and some other countries go further than many parts of the private sector. Publication of standards and reporting to clients on performance are seen as vehicles to promote government openness and accountability. Canadians have indicated that they expect greater government transparency.

14.40 **The Treasury Board should encourage departments to publish service standards and to report performance against them at points of service.**

Performance Measurement

Measures of service performance are not consistently available

14.41 Having relevant and reliable performance information is essential for service managers in their day-to-day work

and for periodic planning and evaluation. Performance measurement is a key ingredient in the Service Standards Initiative, as government attempts to make itself more transparent and accountable to Canadians. Service managers need up-to-date performance data to judge the extent to which their organizations are meeting the established standards. This information would also help to demonstrate the positive results that service managers have obtained through streamlining the process or removing red tape.

14.42 We found that some services have developed systems and procedures to measure various aspects of performance, such as output volumes and labour productivity. However, many do not have systems and procedures to produce reliable and consistent measures of service quality, such as counter waiting time, turnaround time, accuracy of replies and client satisfaction.

Cost information is critical for balancing quality and affordability

14.43 Another important piece of information critical to service managers is the cost of service delivery. Cost data are essential in determining the optimal (or affordable) level of service. In 1992 the Clerk of the Privy Council pointed out, in his PS 2000 progress report, that identifying key drivers of cost and trade-offs between cost and service is one of the essential steps in establishing standards. As we have noted, the essence of the Service Standards Initiative is to ensure that government clients receive high-quality and affordable services.

14.44 We found that many departments do not determine the full costs of delivering services, particularly on a per-unit basis. In cases such as Consular Services, the Passport Office and Parks Canada, efforts have been made to

The essence of the Service Standards Initiative is to ensure that government clients receive high-quality and affordable services.

determine the cost of service using the full range of applicable costs.

14.45 Costs vary with levels of service. Thus, departments need to know what these financial implications are to make appropriate trade-offs between serving client priorities and delivering what is affordable within budget limitations. We found that few services had conducted such “balancing” exercises. One such example was a study by Human Resources Development Canada that determined the costs of different levels of telephone access for its Employment Insurance clients. Telephone service is an area where such a trade-off exercise could be greatly facilitated by the detailed data automatically generated by the related computer software.

14.46 Several services we audited have introduced measures to improve service through process re-engineering and other initiatives. However, they did not always have adequate information on service and cost to demonstrate the actual results.

14.47 In some departments, budget planning tends to take into account such factors as volume and productivity. However, service standards and performance have not been well integrated into the planning process. There are a few exceptions. For example, Customs indicated to us that the periodic measurement of satisfaction with service, compliance levels and waiting times has recently been taken into consideration in its resource review and shift scheduling. If the use of such performance data in an accountability framework is approved, Customs expects that it will result in greater awareness and more active use of the periodic data collected. We believe that this is also likely to promote a more balanced approach to managing service in relation to not only cost but also risk factors, such as the possibility of errors in

detecting non-compliance. Human Resources Development Canada is integrating service standards with productivity measures into its Results-Based Accountability Framework.

14.48 Service managers should collect, analyze and use service and cost performance information as a basis for determining the highest-quality service that can be provided at an affordable cost.

Complaint mechanisms are not well communicated, nor are data analyzed

14.49 Complaint and redress mechanisms give clients a means to resolve their concerns when they feel the government has not met its promised standards of service. Such mechanisms are not only a key feature of service but also an important source of information on performance and improvement. Systematically collecting and analyzing complaints and comments from clients can help service managers to pinpoint system weaknesses, institute remedies and prevent problems from recurring.

14.50 We found that wherever applicable, services inform clients in their program pamphlets about how to appeal unfavourable decisions. Taxation publishes its Problem Resolution Program (a complaint mechanism) in the income tax guides. Customs’ program pamphlet tells clients to see a supervisor if they are unhappy with the service. Generally, however, departments are much less clear about exactly where an unhappy client can go to complain about poor service.

14.51 We found that many services do not systematically collect and analyze complaint data. One exception is Taxation, which collects, synthesizes and analyzes complaint data from the regions. Reports of the proposed solution and status are then sent back to the regions. Taxation has made

use of client complaints as a learning tool to improve service.

14.52 Service managers should clearly communicate to clients how complaints can be made and how they will be redressed. Service managers should also systematically collect and analyze complaint data and devise methods to prevent mistakes from recurring.

Root-Cause Analysis (The Case of Telephone Services)

Serious accessibility problems in government telephone services

14.53 Our review indicated that the telephone service industry focusses on two key aspects of performance: accessibility to the system and quality of the contact. Accessibility is measured by two aspects: (1) the probability that a caller gets into the telephone system without getting a busy signal and abandoning the call while in the queue; and (2) the length of time he or she has to wait before getting an agent on the line. Quality of the contact includes the

accuracy of information clients receive and the interaction with the agent (or the ease of use of the system when the service is automated).

14.54 We found that although the six government telephone operations have not published service standards, several have set internal accessibility targets and measure performance against them. These measures showed that the large government telephone operations we audited had low levels of accessibility (see Exhibit 14.8). For example, Taxation call centres used to have an accessibility target of 70 percent of calls answered on the first attempt, and a waiting-time target of less than 180 seconds on average. In 1995–96 their actual accessibility was 28 percent of all calls (or 23 percent when abandoned calls were included) that did not get a busy signal, although they met the waiting-time target.

14.55 The two smaller government telephone operations (Reference Canada and Canada-Ontario Business Call Centre) had internal targets for accessibility that

While the large government telephone services experienced accessibility problems, the two small operations generally exceeded comparable industry standards.



At Reference Canada, as in other federal government call centres, information officers are equipped with headphones and microcomputers, allowing them to respond as rapidly as possible to clients' enquiries (see paragraph 14.55).

were comparable with the telephone service industry average, and their performance generally exceeded the targets.

Quality of telephone contacts is not monitored regularly

14.56 Once callers get through, they also want to obtain good service. There are many consequences of poor-quality contact. Unfriendly service may cause an immediate negative reaction from the client. Inaccurate answers can send clients

to the wrong place or lead them to send in an invalid application. This can then lead to client frustration, operational inefficiency, or both, contributing to an overall impression of government inefficiency and inaccessibility. It is therefore important for service managers to set appropriate standards and to monitor regularly the quality of telephone contacts.

14.57 We found that although departments recognize the importance of quality of contact and have aimed to provide courteous service and accurate

Exhibit 14.8

Accessibility of Government Telephone Services

Departments and Operations	Accessibility ¹	Wait Time While in Queue	Total Calls Unanswered (Busy and Abandoned)
Human Resources Development Canada Employment Insurance Info-Centres (1995-96)	Target: 95 % on the first attempt Actual: 83%	Target: 80% within 150 seconds Actual: 75.6% within 150 seconds	5,252,850
Human Resources Development Canada Income Security Program Call Centres (1994-95)	Target: 95% after no more than 3 rings ² Actual: 54%	Target: 180 seconds ² Actual: not available ³	2,423,010
Revenue Canada – Taxation General Enquiries (1995-96)	Target: 70% on the first attempt Actual: 28%	Target: 180 seconds Actual: 111 seconds	20,965,681
Citizenship and Immigration Canada Telecentres (1994-95)	Target: ⁴ Actual: not determined	Target: ⁵ Actual: not determined	2,036,628 ⁶
Public Works and Government Services Canada, Reference Canada Telecentre, National Capital Region (1995-96)	Target: 85% within three rings Actual: 93%	Target: 16 seconds Actual: 4 seconds	70,229
Industry Canada and Partners Canada-Ontario Business Call Centre (1995-96)	Target: 85% within three rings Actual: 90.4%	Target: 18 seconds Actual: 7.3 seconds	12,545

Notes:

- 1 Accessibility targets are percent of calls that gain access to the system but do not include calls abandoned while in queue.
- 2 The Income Security Program will be committed to meet this target in 1997.
- 3 Data collection practices vary among call centres.
- 4 In 1994-95, Citizenship and Immigration Canada did not specify a target level and did not measure accessibility.
- 5 Wait time was not assigned a target for the period described. Citizenship and Immigration Canada now has a target of 80% of calls in 20 seconds.
- 6 This number is an approximation as it is based on call volume data collected in April 1995 and projected over a period of 12 months.

answers, only Taxation and Statistics Canada (which also provides enquiry services by telephone) had targets for accuracy of answers to their clients and measured the performance against these targets. In these cases, a “mystery shopper” approach was used to measure the accuracy of information that agents gave to clients.

14.58 We noted that Taxation’s rate of accuracy of answers has varied between 61 and 79 percent in the last few years, with no apparent upward trend. Taxation did not know the impact of its accuracy rate on Canada’s taxation system.

14.59 Silent monitoring is another method used by managers in the telephone service industry to measure and improve quality of telephone contact. Silent monitoring is a technique where a peer, a supervisor or a technical expert monitors the conversations between agents and clients to assess the quality of contact and to identify areas for improvement. Revenue Canada does not use this monitoring technique. The other three large operations, Employment Insurance, Income Security Program and Citizenship and Immigration, stated that they have no objections to silent monitoring, although they do not regularly use the technique.

14.60 We also found that there was little systematic collection and analysis of the nature of clients’ calls and complaints. For example, many of the government telephone centres we visited had not kept ongoing logs of the type of calls they receive (an accepted practice in the telephone service industry) and, therefore, did not have the relevant data to determine whether all calls were actually necessary.

Root-cause analysis can help improve service

14.61 The low rate of accessibility we found in the large government telephone

operations could be caused by a combination of factors. More systematic analysis of performance data, including client feedback, could help service managers to identify root causes of the problems and devise appropriate remedies to improve the quality of telephone service.

14.62 During our audit of government telephone operations, we identified several potential root causes, such as poor measurement, unnecessary calls (including repeated and misdirected calls), lack of operational efficiency and poor quality of answers. We have also noted a number of possible solutions, such as more systematic analyses of the reasons for calls, greater use of technology and better matching of resources to demands. For more details of our analysis see page 14–20, “More about Government Telephone Services”.

14.63 Measures of accessibility for a telephone system can be obtained easily from the software available with that system. However, Citizenship and Immigration phone centres do not collect these data systematically; data collection practices in the Income Security Program vary among call centres and are reported on a national level only partially. This inhibits the ability of these organizations to analyze the root causes and identify improvements.

14.64 Service managers (including telephone centre managers) should collect and use performance data to carry out systematic root-cause analyses, and devise appropriate remedies for resolving persistent problems of accessibility.

Leadership and Management

14.65 Our review of relevant documents and our discussions with service managers indicated that they had many reasons for not having made more progress toward the government’s repeated commitments. The

Systematic analysis of performance data, including client feedback, could help managers to identify root causes of the problems and to devise appropriate remedies to improve telephone service.

MORE ABOUT GOVERNMENT TELEPHONE SERVICES

Growing importance of telephone services in government

Telephone has become the most frequently used method of contact between Canadians and their governments. Canadian citizens made millions of phone calls to federal departments and agencies in 1995. Many of the 13 services we audited had significant telephone operations. We examined four large telephone operations (Income Security Program, Employment Insurance, Taxation, and Citizenship and Immigration) and two smaller operations (Reference Canada in Public Works and Government Services, and Canada-Ontario Business Call Centre). The latter two are gateway services, as one of their major roles is to direct callers to other departments for further action or services.

People call the government for different reasons, usually seeking answers to specific basic questions, such as "Do I qualify?" "Where do I go?" "How do I

approach this?" "What happens to my application?" "Why didn't I get that?" "Whom should I contact?" Clearly, telephone service is an integral part of government services. However, we found that despite its importance and its relationship to other operations, telephone service has not been well linked to knowledge of clients' needs and priorities. Efforts to improve telephone systems could improve service in other parts of operations, and vice versa.

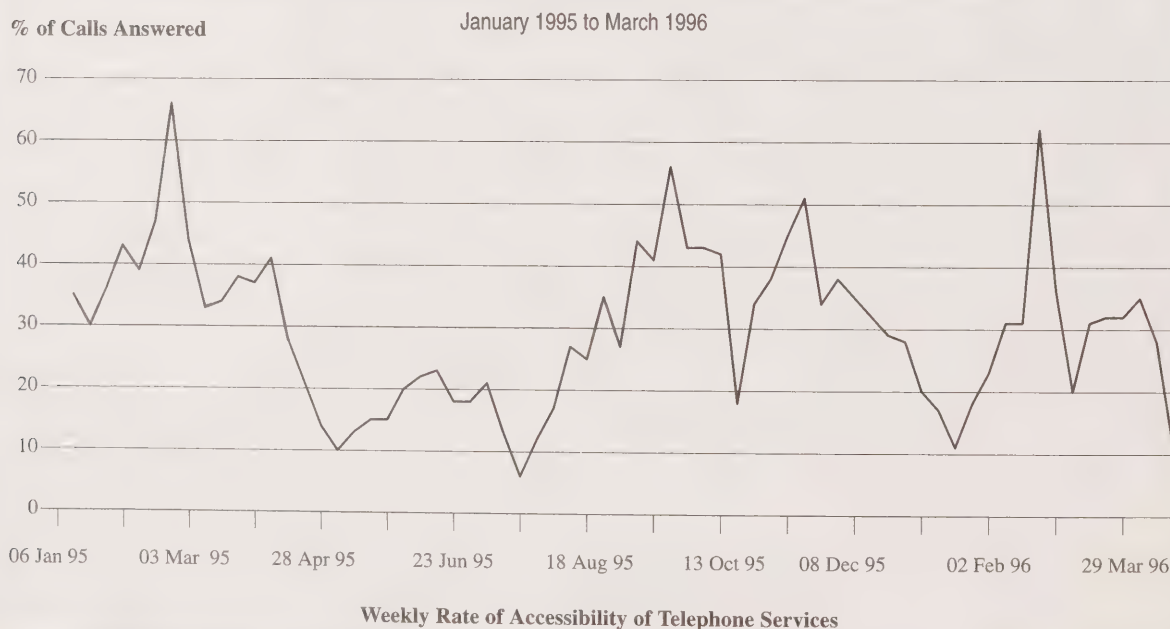
As mentioned elsewhere in the chapter, the large government telephone operations had experienced serious accessibility problems (paragraph 14.54) and careful analysis of performance data, including client feedback, could help service managers identify root causes of the problems and devise appropriate remedies to improve the service (paragraph 14.61). However, call centre managers are often busy handling immediate issues and have little time to

develop longer-term solutions. This section provides additional details of our findings, which may be helpful for them in carrying out root-cause analyses.

Accessibility needs to be better defined and monitored

One important aspect of accessibility measurement is the way "average" accessibility is determined. Averages based on annual national volume are not meaningful to clients who experience difficulties during specific periods of time at a particular location, because accessibility varies from hour to hour, day to day, week to week, month to month and season to season, and also from location to location. Exhibit 14.9 shows that weekly accessibility at the national level in Revenue Canada fluctuates from as low as 6 percent (in July) to as high as 66 percent (in February). Service standards may have to be set for different time periods and managed accordingly.

Exhibit 14.9

Weekly National Variation in Accessibility of Telephone Services Revenue Canada – Taxation

Another important aspect of accessibility measurement is the number of repeat calls made by clients. A caller who encounters a busy signal on the first attempt will often try again and again until he or she is successful, particularly in a government monopoly situation. One example from government phone centres showed that clients in certain locations had tried up to 20 times to reach the centres. Knowledge of the number of repeated attempts (workload) can help service managers to estimate the actual number of clients who need service (demand) and to devise better methods to deal with accessibility problems. It is possible that small adjustments in staffing could reduce the number of repeated attempts and, thereby, improve accessibility significantly. Departments need to consider all of these

implications in managing accessibility targets and telephone service. However, information about repeated attempts was not always available to telephone centre managers at the time of our audit.

Better matching of resources to deal with peak demands

Because of volume variation, it is difficult to allocate the right number of agents to answer calls in accordance with the standards set. However, statistics show that the variations do repeat and that, through better management, it is possible to supply resources to match demand with service. Based on our field interviews with front-line employees and managers of call centres we audited, one way of facing this challenge is to use part-time employees during peak periods. This

would provide a better service to clients by increasing handling capacity to meet the demand while allowing management flexibility in allocating scarce resources.

Through these interviews, we also discovered that good management of human resources is a key attribute of well-managed call centres. Because agents answering the phone often have to face considerable pressures of requirements for productivity and sometimes angry clients, management must be especially sensitive to their needs. An approach that seems to work is to provide occasional assignments away from phones. Where this is done, morale is better; it prevents burnout, which could be costly to the employer, while maintaining and enhancing employees' knowledge of the program.

Exhibit 14.10

Redesigning the Blue Pages to Help the Public Find the Right Telephone Number

In the early 1980s, the Government of Canada introduced the Blue Pages in local telephone directories to help Canadians find right telephone numbers for specific federal programs and services. Today, the Blue Pages also include telephone numbers for other levels of governments. They appear in 148 different directories across the country. The cost to the federal government amounts to a total of about \$6 million per year.

We were informed by the Government Telecommunications and Informatics Services (GTIS) of Public Work and Government Services Canada that the responsibility for the production of the Blue Pages is shared between the various levels of governments represented, regional telephone companies and the private sector companies that publish the directories. GTIS manages the process of collecting all the listings from the various federal departments and is responsible for the administrative tasks of checking spelling errors. Each department is responsible for providing the content and paying for publication costs. Regional telephone companies are responsible for developing instructions and formats and publishing the Blue Pages.

The government has become more complex since the 1980s. In 1990, the PS 2000 Task Force on Service to the Public specifically identified the Blue Pages as an example of published material that is not developed from the client's viewpoint. This conclusion has been supported by other government studies, which concluded that the Blue Pages are inconsistent across Canada; that clients need to know what departments do in order to find the right place to call; and that the Blue Pages assume that average Canadians are well aware of the differences among federal, provincial and municipal jurisdictions.

To address these concerns, some changes have been made to the structure of the Blue Pages. For instance, functional and organizational references were incorporated into an index to reduce the need for users to know which department does what. GTIS has also recently introduced government directory listings on the Internet.

However, in our opinion, other improvements to the Blue Pages are possible. For example, the number of listings could be consolidated and the listings among different departments and in various directories across the country could be made more consistent.

In collaboration with all partners, GTIS has a project under way to address some of the above issues over which the federal government has control. However, there is a need for a single federal organization with the authority to ensure user-friendly content and common format for federal listings.

It is essential to reduce the number of unnecessary calls

There are many kinds of unnecessary calls. One kind that offers potential for reduction is misdirected calls. A study by the Income Security Program found that misdirected calls amount to between 3 and 12 percent of the volume it handles, or between 94,000 and 343,000 calls. Our interviews with personnel in other telephone centres revealed similar situations. One of the contributing factors is the problem of the government listings in telephone directory Blue Pages (see Exhibit 14.10).

Many phone calls are related to the question, "Where is my cheque?" We anticipated that one way to reduce this kind of phone call would be to have more of these payments deposited directly into the recipients' bank accounts without the use of paper cheques. Exhibit 14.11 shows the government's progress in this area.

Another reason for unnecessary calls is the fact that government agents do not have the required information to satisfy clients' initial queries. In some cases, agents do not have access to the information that clients want. For example, agents in Employment

Insurance call centres are facing this problem with up to 10 percent of the enquiries they receive.

Consolidation and technology could improve productivity and service

A study done by Employment Insurance showed that it could save around \$2.5 million annually, mainly through reduction in staff costs, by consolidating its call centres from 29 to 10. Another advantage would be the opportunity to share common platforms, a basis for simpler and more effective implementation of new services, technologies and processes. Finally, consolidation would provide the ability to reroute overflow calls to other call centres. The service currently is consolidating its activities on this basis. Other departments whose telephone operations are presently dispersed, such as Taxation, could also benefit from such measures.

A study done by Employment Insurance shows that a delay of 20 seconds per call to access client information on the computer could translate into \$2.1 million in additional labor costs. Another study by Revenue Canada shows that computer response time

during peak hours in some Ontario Taxation Service Offices is as high as one to two minutes, due to inadequate performance by the computer.

Automated voice response systems help manage calls in a more cost-effective way. They are effective when clients have simple and mechanical questions (for example, where is my monthly cheque?) There is a belief among public servants that service in person is the ideal mode of service. However, experience shows that clients learn to accept and use other means that fulfil their needs adequately. For example, Employment Insurance clients have gradually increased their use of the Department's automated voice response system, to the extent that 60 percent of calls are handled completely automatically. The Income Security Program has recently installed an automated voice response system and has indicated that it is presently analyzing its efficacy in dealing with client inquiries. Taxation has information indicating that a substantial number of the calls currently directed to agents could potentially be handled by automated systems. This could free up resources to provide better service to clients whose requests are more complex.

Exhibit 14.11

Direct Deposit Payments Can Reduce Unnecessary Calls

Direct deposit can be a cost-effective way to reduce the demand for telephone services by lowering the likelihood of receiving calls that ask, "Where is my cheque?" Programs that typically generate such calls deliver millions of regular benefit cheques each month. Public Works and Government Services Canada (PWGSC) is leading a government-wide initiative to promote the use of direct deposit. The number of direct deposits, according to PWGSC, swelled from 5 million in 1991 to 74 million in 1995-96. Old Age Security, the Canada Pension Plan and the Child Tax Benefit now have direct deposit enrolment rates of 63.8 percent, 60 percent and 48.2 percent respectively as of 31 March 1996.

reasons included the public service strike in 1991, government reorganization in 1992, the change of government in 1993 and the subsequent Program Review and associated cutbacks, as well as re-engineering exercises carried out by individual departments.

14.66 As in every endeavour, the failures and successes so far in the implementation of service standards need to be used as lessons for the future. Of course, some of the factors inhibiting progress are beyond the control of individual service managers, but others, as shown below, can be corrected.

Some cultural adjustments will be necessary

14.67 It is important that senior managers buy into the Service Standards Initiative. However, they have had to deal with many other unrelated priorities. The apparent sidelining of the Initiative is evident in the small number of concrete plans and the lack of meaningful responses to the Treasury Board's repeated requests since the early 1990s for departments to report progress in multi-year operational plans.

14.68 Germane to any recent service-related initiative in the federal government has been the recognition that the culture of the organization is a key determinant of success. An important thrust of the Service Standards Initiative is to change the culture of the public service and make it more client-focussed and results-oriented. Such change is long-term in nature and requires sustained leadership from senior management, who must signal the priorities to service managers.

14.69 Deputy ministers need to continue emphasizing their commitment to and support of the Service Standards Initiative, and to integrate service standards into the

ongoing departmental management process. It is the responsibility of the deputy minister to provide leadership to establish a culture that is willing to be held accountable for its performance. One such example is the Trade-mark Branch, where delivery targets are included in the Management and Performance Agreement between the Registrar of Trade-marks and the Deputy Minister (see Exhibit 14.12).

Departments need to focus on major services

14.70 From the beginning of the current Service Standards Initiative, deputy ministers have been earmarked as the key players. They are responsible for establishing clear standards of service in accordance with the deadlines set by the government.

14.71 Departments will continue to face fiscal restraints, making it difficult for them to focus on service standards unless the Initiative is viewed as a tool to improve service delivery, rather than as an additional task that hinders it. We found that departmental approaches to service standards were not concentrating sufficient effort on major services; where departments did have specific goals, they tended not to follow through.

14.72 Departments need to focus on major services and to ensure that sufficient attention is devoted to the initiative. Deputy ministers need to insist on a realistic appraisal of progress. The senior official in charge of each major service needs to be assigned the responsibility for developing and implementing applicable service standards, and for ensuring that accurate progress reports are given to deputy ministers.

14.73 Deputy ministers should ensure that departments focus efforts on major services and should make senior officials

It is the responsibility of deputy ministers to provide leadership to establish a culture that is willing to be accountable for its performance.

accountable for implementing service standards.

Few service managers have complete implementation plans

14.74 The key steps to implementing service standards are set out in the *Treasury Board Guide to the Service Standards Initiative* and reflected in our criteria (see **About the Audit**). We believe that these steps must be carried out systematically and diligently. We expect that each service manager would develop an implementation plan that identifies these key steps; allocates resources to each task and assigns responsibility for it; establishes milestones for all key steps; and monitors progress

against the planned milestones. Spectrum Management's approach gives an example of how good planning helps in the implementation of service standards (see Exhibit 14.13).

14.75 However, we found that although many departments have a team or committee set up to implement service standards, many services do not have a plan, or their plan does not identify key steps and establish milestones. The importance of good planning was also confirmed by a Treasury Board-sponsored Statistics Canada survey (see paragraph 14.80), which found that having a written plan is the best indicator of support of service quality.

Exhibit 14.12

Service Quality Improvement in the Trade-mark Branch

Trade-mark Branch's journey into high-quality service was ignited by the formation of the Canadian Intellectual Property Office (CIPO) as a special operating agency and the creation of Trade-mark as a separate product branch within CIPO in 1993-94. The central issue facing the new Trade-mark Branch was to improve the level of service. With the help of a consultant and the TB guide on service standards, the Director of the Branch enlisted the support of its section heads and began to implement a Client Service Program in the early summer of 1994.

The Branch started by meeting clients to determine their level of satisfaction and asking them for suggestions for improvement. The survey found the overall level of satisfaction to be 68 percent, which was lower than the Trade-mark Branch staff's perception. Three areas for improvement were identified: processing times, accuracy of examination and telephone access.

Internal workshops were held and action items were identified to help improve service levels, with an emphasis on reducing processing time while maintaining the current level of quality. Target turnaround times were established for various stages of processing, from initial filing to final approval. Processing times were tracked and staff was advised of performance against target. Data on trends by month were followed to track improvement over time. Periodic client surveys have been carried out to keep track of the level of satisfaction and to note additional suggestions for improvement.

These targets were communicated to clients initially in the weekly Trade-marks Journal. And, since June 1995, quarterly performance against these targets is displayed in the Trade-mark Branch office in Hull and in the Trade-marks Journal. The results show improvements in some processing areas and deterioration in others. The 1994-95 Management and Performance Agreement between the Registrar of Trade-marks and Deputy Minister of Industry Canada called for a client satisfaction target of 80 percent and a 10 percent improvement in processing time at year end. A client survey done in March 1995 found an 80 percent satisfaction rate with the overall Trade-marks service — up from 68 percent in the summer of 1994. The Branch also reported an improvement in processing times of 19 percent compared with March 1994. The Branch has set a new target of 85 percent client satisfaction for fiscal year 1995-96.

Trade-marks is refining its quality assurance program in order to improve the accuracy of examination, the second area identified for improvement in the first client satisfaction survey. The Branch indicates that, like processing times, standards for accuracy and performance against them will also be tracked and published in the future.

14.76 In our opinion, the absence of appropriate plans has contributed to the overall lack of achievement in the Service Standards Initiative. Without a plan that identifies steps and assigns responsibilities, some key activities, such as client consultation and development of performance measurement systems, may either be skipped or left partially undone.

14.77 Service managers should develop and follow action plans that include all key features for the implementation of service standards.

Government reporting of progress needs to be improved

14.78 The Treasury Board Secretariat is the central agency responsible for the Service Standards Initiative. Its approach to implementation has been to provide government-wide encouragement by supporting departments in meeting performance objectives, acting as a catalyst to remove constraints, and celebrating innovation and success. During the last few

years, the Secretariat has undertaken a range of activities such as bringing the service standards and service quality issues forward to ministers, issuing several series of implementation guides, facilitating interdepartmental networks and emphasizing the need for employee training and participation. Guides issued have clearly presented the quality management approach.

14.79 Informing the Cabinet and Parliament about the overall progress of the initiative is the responsibility of the Treasury Board, supported by the Secretariat. During the first half of the 1990s, the Secretariat asked departments to provide updates on progress made against government commitments and assessed departmental progress against selected criteria to determine how well each department was doing. By 1995, Secretariat staff were relying on surveys and interviews with departmental officials to gather information about progress.

This branch of Industry Canada is responsible for the management of Canada's radio spectrum to ensure high-quality and efficient radio communication services. It offers three major services: licensing of spectrum use; control to minimize interference; and certification of individual operators.

In 1992-93, the branch developed a five-year plan to implement service standards, starting with licensing of spectrum use, which is the largest-volume service. Standards for the other two services are being phased in according to the plan. The five-year plan outlined objectives, key steps and annual targets, and allocation of resources. There was support from senior management; and ongoing consultation with staff in the development of service standards.

Under the plan, surveys of clients are carried out for each of the services. This gives managers a good knowledge of client priorities and levels of expectations with respect to these priorities; this information is used to design client-sensitive service standards.

By June 1995, one set of service standards has been published for licensing, and revision of these standards to include the interference service was in draft form. Standards for the third service are under development. These service standards reflect both client and employee input, and contain information on the nature of the service, a service pledge, specific service delivery targets, and a complaint mechanism. Cost information has not been included, however.

A system is in place in the regions to measure the variance between targets and actual turnaround times for the issuance of radio licenses. Other tools for measuring performance are under development; for example, work is proceeding on client response cards, which will be used to monitor client satisfaction.

Exhibit 14.13

Spectrum Management – A Planned Approach

Little information has been provided to Parliament to indicate clearly the government's progress in implementing service standards.

14.80 In the spring of 1995, on behalf of the Interdepartmental Quality Network and funded by the Treasury Board Secretariat, Statistics Canada conducted a survey to determine the extent of quality management practices in the Canadian public service. Using feedback from managers, the survey concluded that 52.6 percent of units in the public service had client service standards.

14.81 A Treasury Board staff Working Paper on Service Standards, based on interviews conducted in 25 departments during July and August of 1995, concluded, "Two-thirds of departments forecast that by March 31, 1996, they will have developed and published standards for their most important services." It added that considerable work remained to be done, and that strong management and central agency support and encouragement were essential.

14.82 In March 1996, *Getting Government Right* (a report tabled in Parliament with the 1996–97 Estimates)

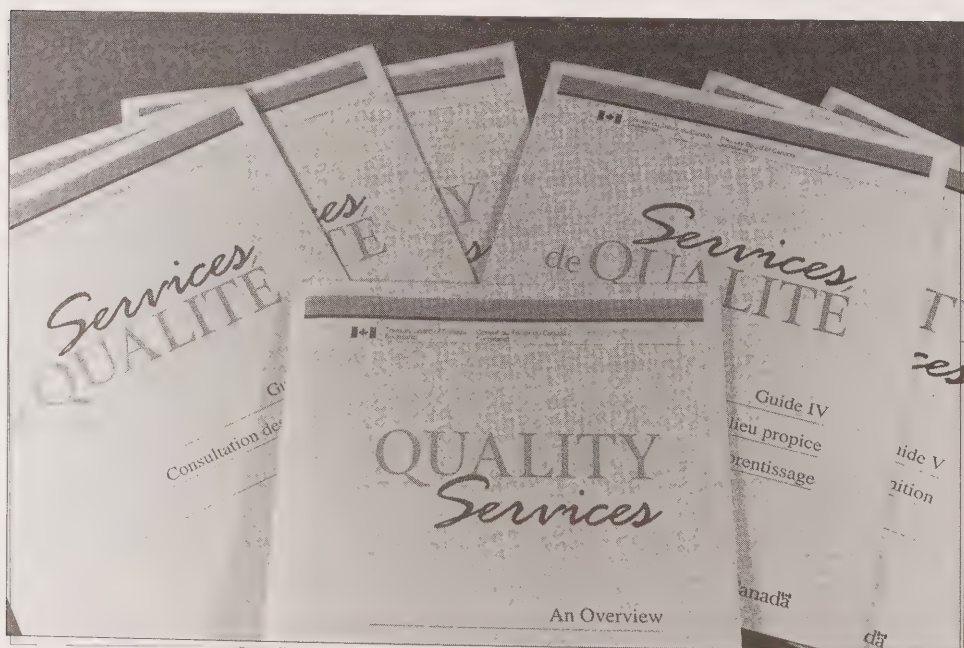
stated that most departments and agencies had published performance objectives for delivery of government products and services, and that these standards set benchmarks against which to measure the timeliness, accessibility, reliability and accuracy of the services to which Canadians are entitled. We were informed by Treasury Board Secretariat that the report was based on the findings of the Statistics Canada survey and on their own interviews.

14.83 *Getting Government Right* is the only recent report to Parliament that has mentioned progress in implementing service standards. It suggested that significantly more than half of the major services had published standards. However, our audit findings show that the actual progress is slower than suggested.

14.84 Information for Parliament needs to be relevant, reliable and understandable. The one brief mention of progress does not meet these criteria.

14.85 Treasury Board Secretariat should report clearly to Parliament the

The Treasury Board Secretariat has published a series of guides on service quality. These guides address topics such as service standards, client consultation, measuring client satisfaction and benchmarking (see paragraph 14.78).



government's progress in implementing the Service Standards Initiative.

Conclusion

Sustained effort is required

14.86 The Service Standards Initiative encompasses many key principles that the government is trying to promote in its current renewal of the public service. Our findings demonstrate a significant gap between repeated government commitments made since 1990 and progress to date. Many services began to develop service standards in the early 1990s, but the progress has been slow and results uneven. A few services almost met the 1995 deadline; however, others made efforts that could only be described as piecemeal.

14.87 More specifically, progress in developing and publishing service standards has varied significantly from one service to another. For example, Parks Canada has consulted with its clients in individual national parks, but has yet to

develop service standards and has just started work on a national performance measurement system. Some services are more advanced in the process. Customs Border Service, for example, has carried out customer-oriented employee training, consulted with clients, set client-sensitive delivery targets and developed a system to measure performance. However, it has stopped short of publishing its service standards (see Exhibit 14.14).

14.88 The service standards approach has become an accepted way of doing business in the Trade-mark Branch. It has followed most key steps in implementing service standards, including the most difficult one — publishing performance against targets and acknowledging to clients that actual performance has been below target. Trade-marks has also integrated measures of quality into ongoing management processes (see Exhibit 14.12). The Customs and Trade-marks cases demonstrate the value of service standards.

14.89 In addition, we found that some departmental front-line offices, whether in a telephone centre or at the counter, are

Some departments are making increasing use of technology and other innovations to improve service to clients.

The Trade-mark Branch and Spectrum Management examples illustrate that service standards can be implemented with good leadership and management.



A client services representative gives instructions on filling out the customs declaration forms to travellers arriving at Pearson International Airport (see paragraph 14.87).

Much in the area of service standards area remains to be done, and sustained effort will be required.

making increasing use of technology and other innovations to improve service to clients. For example, several Passport, Tax Service and Employment Insurance offices have installed automatic queue management systems that allow them to inform clients how long their wait may be and to alert management to adjust the number of staff for counter services. These systems record information such as clients' waiting times, time required to serve clients, and volume by time of day, to provide insightful data on client behaviour, for trend analysis, and to improve service to the public. Citizenship said that it has changed regulations and internal practices to allow group testing and to simplify the application process, in order to speed up the processing of citizenship applications. Reference Canada and the Canada-Ontario Business Call Centre use the information provided by automated telephone systems to adjust resources on an ongoing basis to maintain accessibility targets. The

Consular Service has deployed a real-time computer application, COSMOS, to enable its missions worldwide to retrieve client service information.

14.90 However, none of the 13 services has completed the service standards requirements set out by the Treasury Board. Although there is a growing awareness of the basic concepts, which is a prerequisite to action, much remains to be done and sustained efforts will be required. The Treasury Board Secretariat is currently reviewing its organizational structures and activities. This will provide it with the opportunity to examine how it will lead the Quality Service Initiative and speed up the implementation of service standards.

Treasury Board Secretariat's response: We agree that service standards are an important part of improving the quality of services the federal government delivers to Canadians. The delivery of quality services to Canadians underlies all government

Exhibit 14.14

Customs Border Services – Well on Its Way

Customs Border Services (CBS) serves as a good example because it has taken steps to find out what is most important to its clients. In focus group studies and surveys, clients were asked what they expected when they crossed the border. The important expectations or priorities are speed and efficiency, and professional behavior of the customs officers. To find how CBS performs in these areas, it continuously seeks client feedback by conducting a regular cycle of waiting-time measures and satisfaction surveys at border crossing points across the country. This allows it to see how service has progressed at the local level and nationally since 1993, when it began collecting this information.

Service training for customs officers has been directly linked to information obtained from the focus groups. CBS wants to modify officer behaviour that causes travellers to react in a defensive way or to be dissatisfied with the interaction.

Customs recognizes the need to balance achieving client expectations with minimizing the risk of evasion of duty payment. Concurrently with the regular cycle of waiting-time measurement and satisfaction surveys, CBS conducts a regular cycle of random special examinations of travellers to determine the risk, for example, the rate of attempts to avoid paying duty. Local risk data are combined as well, to give a national picture.

CBS attempts to find the optimal balance between waiting times, satisfaction and risk. Together with its regions and employees, it has established targets in these three dimensions for the coming year. CBS plans to integrate another dimension, resource allocation, into this balance.

While CBS has made noteworthy progress, it has yet to publish its waiting-time standards and costs of delivering its services. Publication of the waiting-time standards is planned for the fall of 1996. Also, CBS could survey those travellers referred for examination in the secondary inspection areas, where some complaints originate.

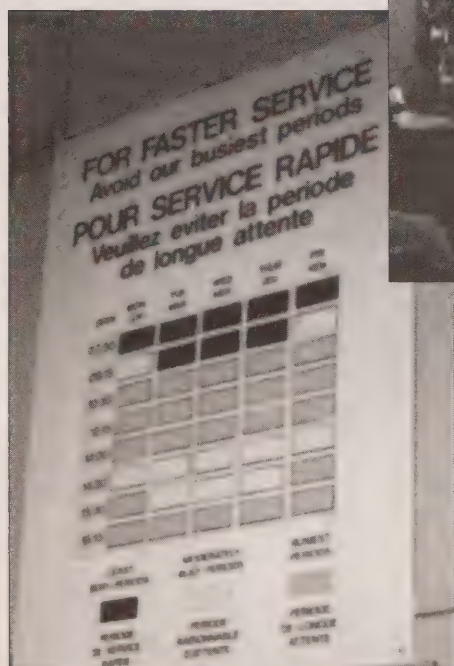
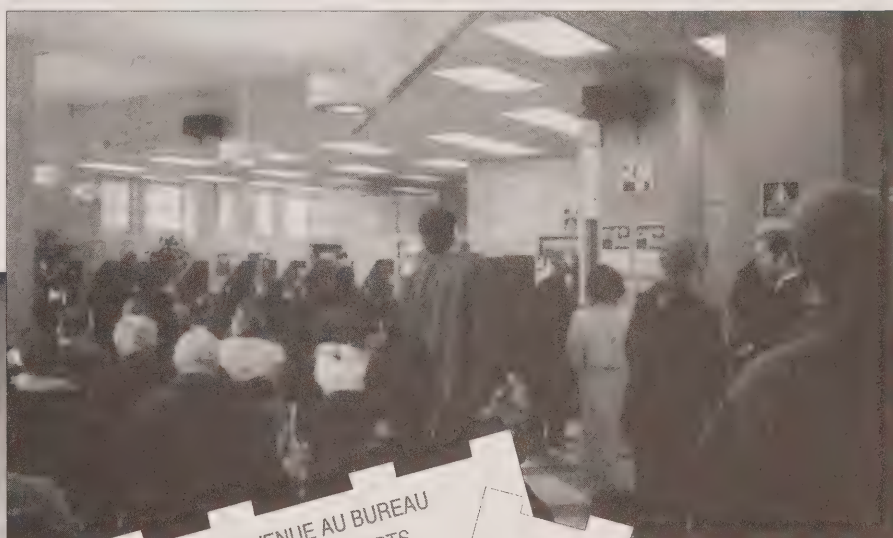
initiatives and priorities and has the government's full support. We welcome the chapter as supporting the pursuit of the objective of quality services for Canadians.

The dramatic changes occurring in the functions and structures of government, along with resource reductions, have created a challenging environment in which to implement service standards. The transitions occurring in what services are delivered, where, how, and the resources available have affected the initiative's implementation and slowed progress. A quality services approach is regarded as a timely step in assisting departments in meeting deficit reduction targets by focussing available resources on those

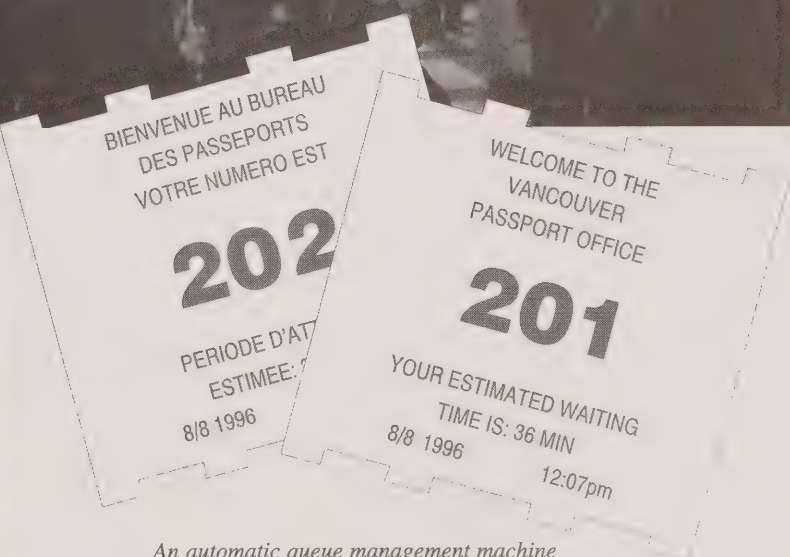
quality services that are relevant, responsive, accessible and affordable.

The government initiative Focussing on the Client: the Quality Services Initiative (June 1995) put the focus on improving client satisfaction. The impetus provided by this initiative is expected to further strengthen ongoing implementation and refinement of service standards, which are an integral part of the initiative. In addition to service standards, a quality approach also stresses client satisfaction, employee involvement, innovation and the celebration of success. This audit focusses on service standards in a sample of service lines and departments. Therefore, much good work done by departments, with respect to this and other

Noon hour at the Vancouver Passport Office is always very busy (see paragraph 14.89).



A colour-coded display board advises clients what the best times are to visit the Passport Office (see paragraph 14.89).



An automatic queue management machine dispenses a ticket telling the client the estimated waiting time (see paragraph 14.89).

quality elements, is not reported in this chapter.

Some elements of service standards implementation are more difficult to achieve than others. Full costing of government services, for example, contains a number of practical problems, given the many changes being implemented within the government's financial management systems. At present, it is impractical in many cases to expend resources to gather and report on the full cost of delivering a service, in a way that is meaningful to clients. Implementation of this element will be facilitated when the changes to modernize the financial management system, now under way, have been completed. Both public and private sector experts acknowledge the implementation of quality services to be a complex process, often requiring five to seven years to implement meaningfully. As many departments are now in the early stages of this work, performance measurement and monitoring schemes in these departments are necessarily in the developmental stage.

We are pleased with the recognition of good practice examples from departments, such as those of Spectrum Management, Customs Border Services, Trade-mark Branch and the leadership of Public Works and Government Services Canada in promoting direct deposit of government payments. We are also pleased that the report recognizes that Treasury Board Secretariat has provided much valuable guidance, support and assistance to departments, whose responsibility it is to implement this initiative for specific services and programs.

We welcome continued monitoring of the government's progress in implementing service standards and improving the quality of its services, as public attention and accountability are important to the continuous improvement process.

We are committed to continued progress in the implementation of service standards and quality services, and will continue to measure and report on progress. The Treasury Board Secretariat will support departments in their implementation of suggestions made by the Auditor General.



About the Audit

Criteria

The criteria for our audit were drawn from general principles that are accepted by quality-management professionals and are reflected in guidance provided by the Treasury Board Secretariat. These criteria, shown below, were used to judge how well the selected government services have implemented service standards and improved services. Because the government's Service Standards Initiative requires that standards include the expected key elements (see Exhibit 14.5), we started our audit by assessing whether these requirements have been met.

- Service line managers have a plan in place for implementing service standards and improving service quality.
- Service line managers know their business, and consult with clients about their needs, expectations, and levels of satisfaction. They know what is affordable.
- Managers set client-sensitive service standards.
- Service standards and performance against them are communicated to clients.
- Reasons for differences between standards/targets and performance are identified and service adjustments are made.
- The above initiatives to improve services to the public are integrated into departmental operations and resource allocation.

Approach

Our examination involved meetings with service managers and staff and a review of files and documentation on service standards. We visited high-volume centres in Canada's major urban areas to observe how the selected services were delivered and what information on service standards was available to the public. In addition, we examined the role of the central agencies.

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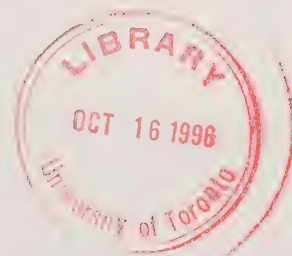
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**Auditor General
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Chapter 15
Federal Science and
Technology Activities: Follow-up

September 1996

**Report of the
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Chapter 15
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Technology Activities: Follow-up**



September 1996

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Cat. No. FA1-1996/2-15E

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Chapter 15

**Federal Science and
Technology Activities: Follow-up**

The follow-up work was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Federal Science and Technology Activities: Follow-up

Assistant Auditor General: Robert L. Lalonde

Responsible Auditors: Richard Flageole and Jacques Goyer

Main Points

15.1 The federal government released *Science and Technology for the New Century — A Federal Strategy* in March 1996. The *Strategy* was accompanied by departmental action plans and a *Framework for the Human Resources Management of the Federal Science and Technology Community*. These initiatives, aimed at addressing certain government-wide concerns noted in our 1994 Report, represent important steps in the right direction.

15.2 We found that science-based departments and agencies are making good progress in focussing their science and technology activities and setting their priorities. Although priorities at the government-wide level have not been enunciated, a mechanism has been established to make recommendations on them to Cabinet. Furthermore, the *Strategy* provides direction to departments and agencies in the form of operating principles and directions for conducting many aspects of their science and technology activities. The challenge will be to ensure that such principles and directions become an integral part of the day-to-day management of activities in science-based organizations.

15.3 The *Strategy* gives full recognition to the importance of departments and agencies working together and increasing intergovernmental co-operation and co-ordination. Various initiatives are also under way to improve the assessment of the results and impacts of federal science and technology activities, and to report on the growth of Canada's knowledge-based economy.

15.4 The positive features of the *Framework* for managing scientific personnel include consultation with and participation of a significant number of stakeholders, leadership of work groups by line-department officials to maximize commitment and ownership, and clearly stated expectations of results. People interviewed believe that work under way addresses issues of critical importance, and that if recommendations are successfully implemented, the outcome could be the resolution of many of the issues we reported in 1994, such as the systematic renewal of scientific personnel and the maintenance of the skills and knowledge base of research establishments. Other initiatives conducted in parallel to the *Framework*, such as modifications to the Work Force Adjustment Directive, have also had positive effects.

15.5 Although progress is being made, we have some concerns, notably about the absence of a forum to share "best practices" and the little attention given to the issue of performance measures and reporting mechanisms for the management of scientific personnel.

15.6 Although we are encouraged by the progress reflected to date in the *Strategy* and the *Framework*, implementation is the real challenge. For this reason, we believe that the government needs to devote considerable attention to establishing results-oriented, time-phased implementation plans for both the *Strategy* and the *Framework*. The government also needs to ensure that accountability for results is clearly established. Implementation will require leadership and perseverance at all levels of government — from ministers to scientists. Parliamentary oversight also needs to continue.

Introduction

15.7 During 1993–94, we conducted a sectoral audit of federal science and technology activities. The results were presented in four interrelated chapters of our 1994 Report — Overall Management of Federal Science and Technology Activities (Chapter 9), Management of Departmental Science and Technology Activities (Chapter 10), The Management of Scientific Personnel in Federal Research Establishments (Chapter 11) and Income Tax Incentives for Research and Development (Chapter 32).

15.8 The House of Commons Standing Committee on Public Accounts held a number of public hearings on these chapters in the spring of 1995. In November 1995, in its Sixteenth Report to the House of Commons on chapters 9, 10 and 11, the Committee recommended that within 60 days after the tabling of the government's science and technology strategy the Auditor General give his opinion on whether the elements set out in that strategy satisfied the concerns raised in his 1994 Report. We submitted our response to the Committee in June 1996, and also informed the Committee of our intention to include this follow-up chapter in the Auditor General's Report to the House of Commons.

15.9 Since 1994, a number of events have significantly affected the context and the environment in which federal science-based organizations operate. In particular, the government completed the Science and Technology Review initiated in 1994 and released, in March 1996, *Science and Technology for the New Century — A Federal Strategy*. The *Strategy* document was accompanied by action plans for nine departments involved in science and technology activities. The government also released a *Framework*

for the Human Resources Management of the Federal Science and Technology Community, a document prepared by the Treasury Board Secretariat.

15.10 During the same period, the government undertook Program Review, a government-wide initiative aimed notably at reducing government expenditures. The expenditure reductions and the resulting downsizing that followed had a major impact on science and technology activities. The government is now in the process of putting in place a new Expenditure Management System aimed at improving planning, reporting and accountability in federal organizations. We took all of these events into account in the conduct of our follow-up work.

15.11 This chapter provides our assessment of the government's progress in addressing our 1994 recommendations on government-wide issues. Details on our audit's objective, scope and approach are included in **About the Audit** at the end of this chapter. Given the various initiatives now under way to "set the stage properly" at the government-wide level, we considered it premature, at this stage, to assess progress in the management of departmental science and technology activities (Chapter 10) and in human resource management at the departmental or research establishment levels (part of Chapter 11). At a later date we will follow up on the recommendations from those 1994 chapters as well as Chapter 32.

Observations

The Federal *Strategy* — An Important Step toward Improving the Management of Science and Technology

15.12 During the course of our 1993–94 audit, the government committed itself to

Since 1994, a number of events have significantly affected the context and the environment in which federal science-based organizations operate.

The release in March 1996 of the federal *Strategy* is an important accomplishment and includes many elements that address the concerns we expressed in 1994.

Science-based departments have made important strategic choices to better focus their science and technology activities.

managing its science and technology portfolio more strategically. In the February 1994 Budget, it announced its intention to “put in place a true strategy, one with real priorities, real direction and a real review of results.” The Minister of Industry had been asked to put forward a paper on science and technology, clearly stating the government’s priorities, to set the stage for an intense national dialogue leading to a new national strategy. To that end, the government launched in June 1994 a major review of federal science and technology activities (the Science and Technology Review) that included a review by federal departments and agencies of their activities, an independent assessment by the National Advisory Board on Science and Technology and public consultation hearings across the country.

15.13 In our 1994 Report, we supported the government’s initiative but noted that similar efforts in the last three decades to implement such a strategy had failed. Building on lessons learned from the past, we offered suggestions and made recommendations to the government for the design and implementation of its science and technology strategy.

15.14 More specifically, we stressed the need for clear priorities and clear direction on who would do what, and how and when desired results would be achieved. We stressed the importance of departments and agencies working together to address overall requirements rather than their own particular interests, and the need for consultation and collaboration with provinces, industry, universities and other stakeholders.

15.15 We also commented on the importance of an effective mechanism for overseeing the government’s science and technology portfolio. We emphasized that it was important for the government to be

better informed about what was being achieved through its spending on science and technology. Finally, we concluded that parliamentarians and the public needed better information on science and technology activities and performance.

15.16 In our opinion, the release in March 1996 of the federal *Strategy* is an important accomplishment. The conduct of the government’s Science and Technology Review and the subsequent development of the *Strategy* required significant effort, commitment and co-operation among science-based departments and agencies and various stakeholders. Although much remains to be done on a number of issues, we believe that the *Strategy* includes many elements that address the concerns we expressed in 1994.

Priorities are being set at the departmental level

15.17 In 1994 we said there was an urgent need to set priorities for science and technology, at both the government-wide and departmental levels. We observed that determining such priorities would require the government to address such fundamental questions as, What are the greatest needs and opportunities? Where must the government be involved and why? Where should and could the government be involved and why? What should and could the government’s involvement comprise?

15.18 We note that science-based departments have made important strategic choices, as part of the Science and Technology Review and the government’s Program Review, to better focus their science and technology activities. For example, the National Research Council of Canada has undertaken a realignment of its research portfolio, and will now focus on five technology clusters or groups:

biotechnology, construction, information and telecommunications, new manufacturing technologies and infratechnologies for measurement and testing. Natural Resources Canada has opted for a stronger emphasis on research activities related to energy efficiency and alternative energy sources. Various priority-setting initiatives are also under way in science-based organizations. Some priorities have been set and are presented in the action plans that accompanied the *Strategy*. The adequacy of the priority-setting practices will be assessed as part of future follow-up work.

15.19 At the government-wide level, the *Strategy* outlines three goals (Exhibit 15.1) to which federal science and technology resources should be directed. It also identifies the federal government's core activities in science and technology (Exhibit 15.2). Our review of the *Strategy* revealed, however, that government-wide priorities have not been enunciated. The *Strategy* recognizes, nevertheless, that "a more rigorous collective review of priorities" is required, and a mechanism has been established to eventually "make recommendations to Cabinet on the government's S&T priorities."

A mechanism to set priorities and co-ordinate activities at the ministerial level

15.20 In 1994, we commented on the absence of an effective mechanism for overseeing the government's science and technology portfolio. We believed that such a mechanism was needed, for example, to lead the development of government policies, to lead government-wide reviews and priority-setting exercises, and to monitor overall trends, performance and results. We recommended that the government "put in place an effective framework to co-ordinate the activities of departments and agencies in achieving the intended results of its new S&T strategy."

15.21 In conjunction with its Science and Technology Review, the government received a number of suggestions for changing the structure and processes of decision making for science and technology at the federal level. The government concluded that it should strike a balance between a centralized and a decentralized structure for such decision making. The *Strategy* states, "Under our parliamentary system of government, ministers must retain the capacity to direct their departments' efforts and resources,

Our review of the *Strategy* revealed that government-wide priorities have not been enunciated.

Sustainable Job Creation and Economic Growth

To ensure that Canada is among the best in the world in applying and commercializing S&T for sustainable job creation and economic growth.

Improved Quality of Life

To ensure that Canada applies S&T to improve the quality of life for our citizens through the creation of fulfilling jobs and through the most effective social, environmental and health care programs in the world.

Advancement of Knowledge

To create in Canada world centres of excellence in scientific discovery; to build a broad base of scientific enquiry; to foster Canadian participation in all major fields of science and technology; and to ensure that new knowledge can be acquired and disseminated widely, from Canadian sources and from around the world.

Exhibit 15.1

Three Goals for Science and Technology (S&T) Activities

Source: *Science and Technology for the New Century — A Federal Strategy*, Government of Canada, March 1996

including their science and technology resources, and be accountable for results.”

15.22 Consistent with this approach, the Economic Development Policy Committee of Cabinet will be mandated to review, as part of the government’s overall planning and accountability framework, the performance of federal science and technology activities and to make recommendations to Cabinet on related priorities. This review will be based on an annual report to Cabinet on science and technology activities in the federal government. An Advisory Council on Science and Technology has also been established to advise the Committee on the nation’s performance and emerging issues in science and technology; the Council replaces the former National Advisory Board on Science and Technology. The Minister of Industry, supported by the Secretary of State (Science, Research and Development), will lead the co-ordination of science and technology policy and strategies across the federal government. A committee of representatives from external advisory bodies to federal departments and agencies will provide them with advice on issues common to federal science-based departments and agencies, such as co-operation and multidisciplinary collaboration, and harmonization of science and technology policies and strategies across departments and agencies. The management regime will be implemented within the framework of the

new government-wide Expenditure Management System.

15.23 Overall, we consider that the management regime outlined in the *Strategy* represents a positive step in responding to our recommendation. However, given that the new Expenditure Management System focusses on departmental activities whereas many science and technology issues cross departmental boundaries, we believe that the government needs to pay particular attention to the following questions: Who will be responsible for establishing government-wide expectations for performance, for monitoring that performance and for taking remedial action where performance is not meeting expectations? In implementing the *Strategy*, what will be the specific roles of Industry Canada, Treasury Board Secretariat and other important players, such as the Interdepartmental Steering Committee on the Management of Science and Technology? (The latter is a committee of assistant deputy ministers from science-based departments and agencies.)

Clearer direction is provided for the management of departmental activities

15.24 The *Strategy* provides much better direction to science-based departments and agencies on ways and means of conducting various aspects of their activities. It outlines a common framework of seven operating principles (Exhibit 15.3) to guide the design and implementation of their science and technology programs and activities and the management of their day-to-day operations. For each of the operating principles the *Strategy* outlines a number of specific directions. Appendix 1 summarizes the specific directions provided under the seven operating principles. These operating principles and

Exhibit 15.2

Core Science and Technology Activities of the Federal Government

Source: *Science and Technology for the New Century — A Federal Strategy*, Government of Canada, March 1996

1. Funding and performing scientific research to support the mandates of departments and agencies
2. Supporting research in universities, colleges, hospitals and other non-governmental research institutions and Networks of Centres of Excellence
3. Supporting private sector research and development

directions require federal organizations to prepare strategies or action plans or to take measures aimed at, for example, increasing the effectiveness of federally supported research, or emphasizing preventive approaches and sustainable development.

15.25 As stated in the *Strategy*, the ways departments and agencies apply these principles and directions will vary depending on their specific roles and responsibilities. The principles and directions will also provide a basis for measuring and evaluating results under the new management regime outlined in the *Strategy*. Departments' action plans provide more details on how each one intends to implement these principles and directions.

15.26 Those operating principles and directions constitute positive steps to address some of the concerns we raised in 1994. For example, the transfer of knowledge and technology is an explicit federal objective, and the efforts of departments and agencies to meet it are to be closely evaluated. More emphasis is also placed on developing research consortia, alliances and linkages with industry, provinces, universities and other stakeholders. The importance of increasing interdepartmental collaboration to combine efforts and eliminate duplication is reinforced. Direction is also provided on ways and means of enhancing the excellence and relevance of research.

We had expressed concerns about all of these elements in our audit of departmental science and technology activities.

15.27 Putting into practice the operating principles and directions outlined in the *Strategy* may pose a particular challenge in areas where individual departments and agencies have few incentives to move in a specified direction. For example, the *Strategy* notes the government's agreement with the position of the National Advisory Board on Science and Technology: "Where it is more appropriate, feasible or cost-effective, federally funded science and technology activities should be performed in the private sector or in universities." Departments and agencies are thus required to "regularly and systematically assess whether their performance of science and technology might be better carried out by others." As we noted in 1994, a similar requirement had been included in the 1987 decision framework for science and technology. Yet, as we observed then, of total federal spending on science and technology, the proportion represented by in-house activities had decreased by only one percent, from 60 percent in 1987–88 to 59 percent in 1993–94.

15.28 To ensure that the operating principles and directions become an integral part of day-to-day management, we believe the government will have to

Putting into practice the operating principles and directions may pose a particular challenge in areas where individual departments and agencies have few incentives to move in a specified direction.

1. Increasing the effectiveness of federally supported research
2. Capturing the benefits of partnerships
3. Emphasizing preventive approaches and sustainable development
4. Positioning Canada competitively within emerging international regulatory, standards and intellectual property regimes
5. Building information networks: the infrastructure of the knowledge economy
6. Extending science and technology (S&T) linkages internationally
7. Promoting a stronger science culture

Exhibit 15.3

Common Framework of Operating Principles

Source: *Science and Technology for the New Century — A Federal Strategy*, Government of Canada, March 1996

One significant outcome of the Science and Technology Review: science-based organizations are more aware of the need for closer ties and improved relationships.

put in place a strong monitoring and accountability framework that includes specific targets for results and indicators of performance, and an effective system to measure and report on performance. We have been informed by Industry Canada that the Interdepartmental Steering Committee has begun work on such issues.

Departments and agencies are working together more closely

15.29 In 1994 we stressed the need for federal departments and agencies to work together to address overall requirements rather than their own particular interests. Throughout our follow-up, we found evidence that one significant outcome of the Science and Technology Review has been to make people in the various science-based organizations more aware of the need for closer ties and improved relationships among them if some issues are to be tackled successfully.

15.30 For example, a new initiative, Federal Partners in Technology Transfer, unites 13 departments and agencies to promote the commercialization of technologies transferred to the private sector. In addition, a memorandum of understanding on science and technology for sustainable development has been signed by Agriculture and Agri-Food Canada, Environment Canada, Fisheries and Oceans Canada and Natural Resources Canada to foster collaboration and co-ordination, and to work together on specific projects.

More emphasis is placed on intergovernmental co-operation and co-ordination

15.31 In 1994, we recommended that the government ensure that the new federal science and technology strategy would be the result of concerted efforts

among all stakeholders. We emphasized that policy consultation and co-ordination with provinces and territories were important to avoid loss of synergy and duplication of effort. We also stressed the need for similar consultation and collaboration with industry and universities.

15.32 The *Strategy* gives full recognition to the importance of intergovernmental co-operation and co-ordination. It states that the government will initiate results-oriented discussions with provincial and territorial governments aimed at identifying new, practical forms of partnership, co-operation and co-ordination in related areas of mutual interest. The *Strategy* also requires federal science-based departments and agencies to develop explicit strategies for working with their provincial and territorial counterparts on activities of mutual interest. We note that progress is being made; for example, Industry Canada, the National Research Council and Western Economic Diversification Canada are working with the four Western provinces to examine opportunities for clustering technology. The Secretary of State (Science, Research and Development) has also initiated a series of meetings with his provincial counterparts to discuss issues of mutual interest and opportunities for co-operation and collaboration. On a broader basis the *Strategy* states, "In the months ahead, the federal government will work with the provinces and territories, the private sector, universities, the research community, not-for-profit organizations and others toward developing a full national science and technology strategy for the Canadian innovation system."

15.33 We are pleased to see that the government recognizes the importance of ensuring that all stakeholders work

together to achieve the national goals outlined in the *Strategy*. This is an essential condition for its success.

Initiatives are under way to improve performance measurement

15.34 In 1994, we concluded that the federal government would have limited ability to make sound decisions until it had better information on results in its science and technology portfolio. We recommended that the government define, design and implement a framework for assessing its science and technology activities. We also offered suggestions about what such a framework should include.

15.35 Although much remains to be done, various initiatives are presently planned or under way that address our recommendation. For example, at the government-wide level, Statistics Canada is working on a project to design, develop and implement an information system to inform Canadians about the effectiveness of government initiatives in promoting innovative activity and diffusing technology, and about the country's progress in becoming more innovative and more competitive internationally. Another initiative is a new Research and Development Impact Network initiated by Natural Resources Canada, Treasury Board Secretariat and research partners to advance the assessment of research and development impacts, so that science-based departments have simple, credible and broadly accepted tools for performance measurement.

15.36 The *Strategy* also indicates that each science-based department and agency is to set clear targets and objectives, establish performance measures based on impacts, and develop evaluation frameworks within the context of the new Expenditure Management

System. This is a significant and complex task. We observed in 1994 that many federal science-based organizations were far from meeting such expectations. We will assess the degree of progress in this area in future follow-up work.

Information to Parliament and the public is to be improved

15.37 In 1994, we noted that there was no comprehensive reporting on federal science and technology activities. We concluded that parliamentarians had no basis to assess whether the government's expenditures on science and technology reflect Canadian needs and opportunities, or to hold the government accountable for results.

15.38 The *Strategy* states that information on science and technology programs and activities of individual departments and agencies will be made available to Parliament and the general public through the cycle of the Expenditure Management System. To that end, the *Strategy* requires each department and agency responsible for science and technology expenditures to prepare a report on its related priorities, key initiatives, spending plans, management challenges and performance measures as part of its annual "Departmental Outlook" (which will be replaced by departmental plans). The Expenditure Management System also provides for separate "departmental performance reports" to be tabled in Parliament each fall.

15.39 We consider that departmental plans and departmental performance reports offer a potential for improving the information on science and technology activities of specific departments and agencies presented previously in Part III of the Estimates, which tended to focus on program inputs and activities rather than results.

There is a need for consolidated information on science and technology activities.

The Treasury Board Secretariat, in collaboration with science-based departments, has undertaken a number of initiatives aimed at addressing our concerns about the framework governing the management of scientific personnel.

15.40 However, we believe that more needs to be done. As we observed in 1994, there is a need for consolidated information on the performance of departments and agencies, on government-wide and horizontal issues, and on Canada's performance in science and technology overall. Although the *Strategy* provides for a consolidated report to be prepared annually for Cabinet, there is no requirement to make the information available to Parliament and the general public. We note, however, that the Interdepartmental Steering Committee recently recommended that the government produce such a consolidated report for parliamentarians and the public. We have been informed by Industry Canada that the Minister of Industry, in the near future, will be taking this recommendation to the Economic Development Policy Committee of Cabinet for consideration.

Positive Steps Being Taken in Relation to the Management of Scientific Personnel

15.41 In our 1994 Report, we noted the need for a more strategic approach to the management of scientific personnel in research establishments. We also said that developing a stronger capability in research management needed to be a real priority. We commented that the same or similar issues had been raised many times over the last three decades. Some of the causes identified for the lack of resolution of these issues included:

- the lack of clear direction for science and technology activities, which impacts on the ability to plan and manage human resource efficiently and effectively;
- an overemphasis on government-wide uniformity in the current approach to human resource management;
- systemic constraints to the effective and efficient management of scientific personnel; and
- the lack of an interdepartmental forum for dealing with human resource management issues affecting scientific personnel, given the scattering of research establishments.

15.42 In November 1995, in its Sixteenth Report to the House of Commons, the Standing Committee on Public Accounts recommended that the Treasury Board determine what responsibilities and authorities it intended to transfer to science-based departments to make the framework for managing human resources in the public service more flexible and better adapted to their needs. The Committee also recommended that the Treasury Board submit a timetable for such a transfer. It also requested that, starting in December 1995 and in June and December of each subsequent year, the Treasury Board submit a report on the status and progress of initiatives related to the management of scientific personnel. Finally, the Committee expressed a desire to be informed of the progress made in establishing a forum devoted to issues in the management of scientific personnel, including its objectives, participants, frequency of meetings and so on.

15.43 We found that the Treasury Board Secretariat, in collaboration with science-based departments, has undertaken a number of initiatives aimed at addressing our concerns about the framework governing the management of scientific personnel. The most significant of these initiatives were outlined in *A Framework for the Human Resources Management of the Federal Science and Technology Community*.

15.44 Other parallel initiatives and ad hoc measures have also been taken. While some of these initiatives were not aimed at

addressing problems specific to the scientific community, many nevertheless have or are likely to have a significant impact on this segment of the public service. Modifications of the Work Force Adjustment Directive in 1995 and work being done to further develop the *Universal Classification Standard* — the new job evaluation system developed by the Treasury Board Secretariat — are two examples of such parallel initiatives.

The Framework is a significant step in the right direction

15.45 In 1994, we recommended that Treasury Board review the existing policies, systems and practices so that it could develop, where cost-effective, a tailor-made and decentralized human resource management regime with appropriate accountability mechanisms.

15.46 The *Framework*, made public in March 1996, describes some of the most important initiatives taken that address our concerns. The document contains the objectives and it identifies the challenges and issues faced by science-based organizations. It also describes the management structure put in place to address human resource issues — a senior-level steering committee, five work groups and a science and technology unit within the Treasury Board Secretariat. Exhibit 15.4 outlines the objectives set for the human resource management framework and the terms of reference of each of the five work groups.

15.47 In our opinion, and in the opinion of many of the people we interviewed, the positive features of this undertaking include:

- the initial consultation of a significant number of stakeholders, such as scientists and officials in major science-based organizations;

- the active participation of some 150 people at all levels, including assistant deputy ministers, research scientists, research managers and human resources specialists as well as an important number of representatives from the Professional Institute of the Public Service of Canada (PIPSC), the bargaining agent representing many scientific personnel;

- the inclusion of not only issues we identified in 1994 but also other human resource issues, identified during the Science and Technology Review or in business plans of science-based organizations, such as the need for improved rewards, recognition and incentives;

- leadership of each work group by a line-department official, supported by a “champion” at the assistant deputy minister level, to maximize commitment and ownership; and

- clear expectations of results along with an indication of their relative priorities, and an assessment of their levels of difficulty.

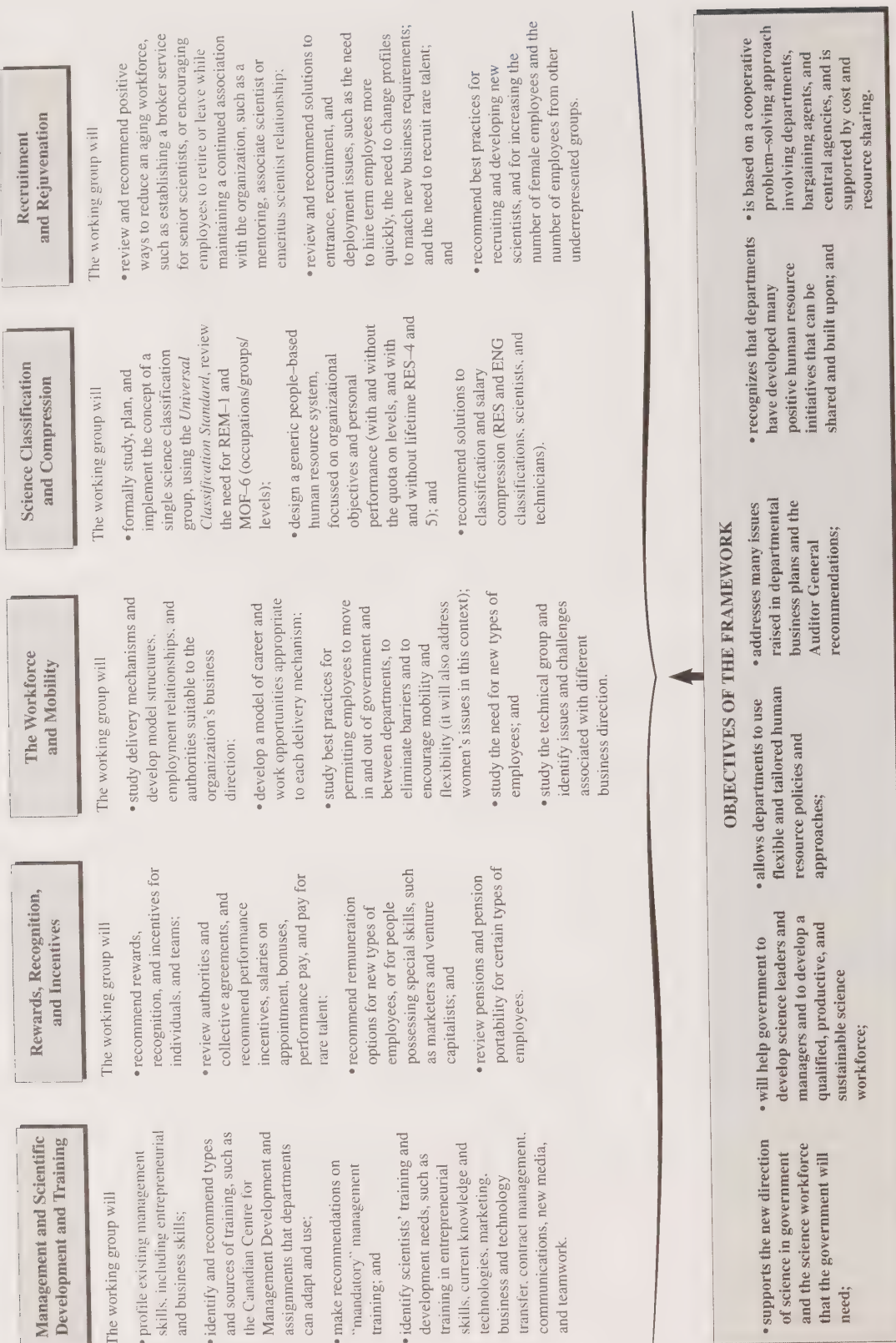
15.48 Because of their scope, some of the projects under the *Framework* have the potential to affect not only researchers and other scientists but also technologists, technicians and support personnel. Although we noted the absence, until recently, of unions representing a significant number of scientific personnel, Treasury Board Secretariat officials have informed us that a number of unions were invited and have now agreed to participate in future activities.

15.49 Overall, people we interviewed in science-based organizations believe that the five projects undertaken by the work groups (Exhibit 15.4) address issues of critical importance to their respective organizations. They believe that, overall, these projects have the potential to provide a more flexible human resource management framework, better suited to

The Framework, made public in March 1996, addresses not only issues we identified in 1994 but also other human resource issues identified during the Science and Technology Review or in business plans of science-based organizations.

The five projects undertaken by the work groups have the potential to provide a more flexible human resource management framework, better suited to science and technology activities.

Objectives of the Human Resource Management Framework and Terms of Reference of Working Groups



Source: Adapted from *A Framework for the Human Resources Management of the Federal Science and Technology Community*, Treasury Board Secretariat, March 1996

science and technology activities. Many believe that if there is a consensus on the recommendations coming out of the work groups, and if those recommendations are implemented, the outcome could be the resolution of many of the issues we reported in 1994, such as the systematic renewal of scientific personnel; career progression or mobility; and the maintenance of the skills and knowledge base in research establishments. Furthermore, some believe that if successful, the initiative could lead to similar initiatives in the rest of the public service. We agree with this assessment.

15.50 It is important to note, however, that the *Framework* is aimed mostly at “setting the scene” and that it will provide only broad parameters or illustrations of “best practices”. Substantial work will have to be done in research establishments and departments to achieve results. For example, it would not be practical or realistic to expect that the work group mandated to examine training and development issues can determine the specific knowledge and skills required in a given set of circumstances or in a particular environment.

15.51 At the conclusion of our follow-up work, the work group responsible for addressing issues of management and scientific development and training had tabled its report and made a number of recommendations to the steering committee. Other groups were working diligently, although some were delayed temporarily as they waited for issues related to classification and job evaluation to be resolved first.

Other important parallel initiatives have been undertaken

15.52 **Modifications to the Work Force Adjustment Directive facilitated downsizing, but renewal and**

rejuvenation remain an issue. In 1994 we reported that the Work Force Adjustment Directive — notably, its guarantee of a reasonable job offer to any employee declared surplus — was a major constraint to restructuring, downsizing and effective and efficient management of scientific personnel. Because they are often highly specialized, scientific personnel do not always have access to other job opportunities if they become surplus to requirements.

15.53 In 1995, the government announced several important modifications to the Directive. One important change was the introduction for a three-year period of improved financial incentives for people declared surplus who are interested in retiring or leaving the public service. These financial incentives include the Early Retirement Incentive, which permits people aged 50 or older to retire without pension penalties, and the Early Departure Incentive, which can be claimed by any public servant declared surplus to requirements, irrespective of age. The latter is intended to apply only to departments considered “most affected” by expenditure reductions or the results of Program Review. Among the most affected departments are the four science-based departments included in the scope of our 1994 audit.

15.54 Another modification to the Directive was introduced in 1995 as a result of pressure from unions. This provision permits employees who are interested in retiring or leaving the public service to swap jobs with public servants likely to be declared surplus but who want to remain in the public service. Use of this provision is subject to approval by management.

15.55 All science-based organizations we visited commented that the modifications to the Work Force

The Framework is aimed mostly at “setting the scene” and it will provide only broad parameters or illustrations of “best practices”. Substantial work will have to be done in research establishments and departments to achieve results.

Modifications to the Work Force Adjustment Directive were not only useful but also essential to the successful implementation of expenditure reductions and the consequent downsizing that resulted from Program Review.

While some managers claimed some improvement in the renewal and rejuvenation of their scientific personnel, many more reported that the situation had deteriorated.

Adjustment Directive were not only useful but also essential to the successful implementation of expenditure reductions and the consequent downsizing that resulted from Program Review. The modifications also helped to minimize negative impacts on the people affected. Information obtained from both the Treasury Board Secretariat and departments indicates that, although science-based organizations we visited have been significantly affected by downsizing, they have had to lay off few people.

15.56 In a number of cases, science-based departments or research establishments were able to make successful use of the swapping provision. For example, two departments were able to move some 15 persons from one location to another by using the swapping provision and special relocation assistance. Had this not been possible, many would have been laid off. People acknowledged that the exercise had demonstrated more opportunity for career mobility than they had initially believed existed.

15.57 We found that the impact of downsizing on renewal and rejuvenation efforts varied greatly from one research organization to another. In a number of cases, downsizing meant that science-based organizations lost a significant portion of their most senior and experienced scientists, as well as a significant number of their youngest scientists — often recent recruits with high potential. Many of the more experienced employees opted for retirement, and new recruits, often term employees, were released to protect the positions of indeterminate employees. As a result, these organizations now face an even greater challenge in the renewal and

rejuvenation of their scientific personnel than in 1994.

15.58 In 1994 we reported that science-based organizations were generally aiming at a better balance among indeterminate, term and other categories of employees. We noted the need to encourage career mobility or early retirement to create opportunities for hiring young graduates, given a greater emphasis on applied research, revenue generation and partnerships. We also reported that, in many instances, renewal and rejuvenation were being achieved by using money from “sunset” programs such as the Green Plan, or money generated through partnerships, to recruit new scientists on a term or indeterminate basis.

15.59 While some managers we interviewed in our follow-up claimed some improvement in the renewal and rejuvenation of their scientific personnel, many more reported that the situation had deteriorated for a number of reasons. For example, direct funding for Green Plan activities is gradually being reduced. Furthermore, because the Work Force Adjustment Directive is aimed at facilitating downsizing and minimizing its impact on indeterminate employees, term employees had to be let go, employees who left could not be replaced and salary dollars were taken away. Except where reductions in direct funding are offset by revenue generated from other sources, renewal and rejuvenation of scientific personnel remains an important issue that needs to be addressed in most science-based departments or research establishments we visited.

15.60 Management has used the flexibility provided by the suspension of the five-year limit on term appointments. In 1994, we reported that the policy of a five-year limit on term appointments created problems for

research establishments when research projects lasted longer than five years. Under that policy, any person employed for five consecutive years as a term employee was automatically appointed as an indeterminate — that is, “permanent” — employee, irrespective of the duration of the research project to which the person was assigned. This forced research establishments to find complicated and often costly ways to avoid making such indeterminate appointments — for example, by terminating employment and eventually rehiring the same person or hiring another scientist for the completion of the project.

15.61 In 1995 the government suspended for three years the application of the five-year limit on term appointments, and exempted from the five-year limit those research projects funded by industries and universities. This new flexibility has been used by most research establishments when they believe it is warranted by the nature of their projects. The suspension of the five-year limit has not prevented some research establishments from making indeterminate appointments where justified. While managers expressed satisfaction with the suspension, union officials interviewed expressed concerns about important differences in conditions of employment between term and indeterminate employees and the impact on recruitment and retention, for example. They considered that alternative solutions are needed to balance the difficulties of term employment and the pressures faced by managers.

15.62 Revisions are being made to the *Universal Classification Standard* to capture work performed by scientists.

In 1994 we reported that existing classification and job evaluation systems created a number of significant obstacles

to the efficient and effective management of scientific personnel. In May 1996 we reported to the House of Commons our observations and recommendations on the reform of classification and job evaluation in the public service. We concluded that, unless reviewed, the *Universal Classification Standard* — the new job evaluation tool being developed by the Treasury Board Secretariat — could not be used to evaluate all jobs in the public service, including jobs performed by some scientists. We also concluded that there were significant opportunities to simplify the occupational group structure — as we had recommended for scientific personnel in 1994 — and job evaluation and other related systems in the public service. Acting on our recommendations, the Treasury Board Secretariat is currently reviewing the *Standard* to ensure that it can capture work performed by scientists. While this work is under way, the simplification of the occupational structure for the scientific community is being addressed by one of the work groups set up under the *Framework* for managing scientific personnel.

15.63 Ad hoc measures have been taken to meet specific needs. Following the presentation of business plans by science-based departments, the Treasury Board and its Secretariat have responded positively to some specific requests for additional flexibility in human resource management, such as temporarily changing the quota system governing the promotion of researchers at senior levels or authorizing the creation of a tailor-made interchange program.

The most important change — emergence of a management-oriented and businesslike culture

15.64 We reported in 1994 that there was a need to change the culture prevalent in many research establishments, which

Perhaps the most important change taking place is not just systemic; it is a change in values, mindset, attitudes and practices.

was focussed primarily on scientific achievement, peer recognition and individual contributions, to one that emphasized a management-oriented and businesslike culture. Evidence gathered, meetings and discussions indicate that perhaps the most important change taking place is not just systemic; it is a change in values, mindset, attitudes and practices.

15.65 For example, people we interviewed who participated in the Program Review and the Science and Technology Review, and who are participating in the various work groups set up under the *Framework*, appear to be more aware, better informed and more sensitive to the importance of the human resource issues that they or their colleagues in other departments face. Furthermore, as reported in paragraph 15.30, there is evidence that people are now working together more closely. People interviewed also perceive a significant and positive change in the role played by the Treasury Board Secretariat and in its approach to human resource issues. Union officials we interviewed said that members participating in the various work groups were treated like any other participants, without the “us and them” mentality that too often characterized relationships between unions and management. They felt that an attitude of problem solving rather than confrontation permeated the discussions of the work groups. In addition, one union member is working in the science and technology unit of the Treasury Board Secretariat.

15.66 There are other tangible indications of such an evolution. There is evidence that experimentation is being used more frequently before fundamental change is introduced. For example, pilot projects are now under way to experiment with short-term assignments of scientific

personnel among departments, and with “employment contracts”.

15.67 We also found evidence of more strategic thinking; human resource issues appear to be addressed from a more strategic perspective. Science-based organizations we visited claimed to have developed human resource strategies more consistent with their missions, programs, culture and values. We will assess progress in this regard in future follow-up work.

Some concerns remain

15.68 While there is evidence that many human resource issues we identified in 1994 are being addressed and that progress is being made in developing a flexible framework better suited to the management of scientific personnel, we still have concerns about a number of issues. Addressing these concerns could significantly increase the chances for success of the various initiatives under way.

15.69 The absence of a forum to share “best practices” and discuss issues of common interest. In 1994, we recommended that the government create a forum dedicated to issues related to the management of scientific personnel, supported with appropriate means to be effective. Up to now, the government’s emphasis understandably has been on long-standing issues and on projects with specific objectives and relatively short time frames. However, we believe there is still a need for a forum to share best practices, to periodically discuss or analyze emerging issues, to find solutions to new problems and to report on progress in developing the new human resource framework or addressing known human resource issues such as renewal and rejuvenation. At the conclusion of our follow-up work, it was not clear what mechanism would be used to ensure that

the synergy currently developing is not lost.

15.70 In this context, we are also concerned about the part-time and temporary nature of the science and technology unit in the Treasury Board Secretariat, given its mandate, the task ahead and the limited resources currently available. This unit is currently staffed with three people, including one whose salary is partially funded by a department. A reassessment of the resources allocated at this level may be necessary.

15.71 Little attention given to performance measurement, reporting and “values”. The *Framework* document identifies a number of elements considered necessary for the effective management of the scientific community. These elements include structures, delivery mechanisms, authorities and policies, productive and qualified staff, matching people and work as needed and an enabling working environment. Such elements are indeed important.

15.72 We believe, however, that other elements are to be considered important as well. For example, in 1994 we emphasized the urgent need for a much-increased delegation of authority to science-based departments for the management of their scientific personnel but we also recommended that appropriate accountability mechanisms be developed. Given that the *Framework* will likely result in a more decentralized human resource management regime, some attention needs to be devoted to the issue of accountability for the management of scientific personnel. What performance should be expected of research establishments, science-based departments and, within these, research managers in managing scientific personnel? What should the performance indicators be?

How should performance be assessed?
Should there be reporting requirements?

15.73 Similarly, in the public service a number of principles or “values”, such as political neutrality, accessibility, transparency and equity, are considered basic. In a context where research establishments will engage more in partnerships and shared-cost programs and where rules governing the management of scientific personnel are likely to be significantly modified or eliminated, some attention to the issue of “values” is needed. For example, what principles should govern the hiring of scientific personnel under “employment contracts”? Should conflict-of-interest guidelines be modified to allow employees to benefit from the spin-off of scientific activities?

15.74 Ensuring that authority is delegated to the level best placed to exercise it. When authorities are delegated from central agencies to departments or when controls are abolished because they are considered ineffective, there are risks that the authority may not be sub-delegated to the level best placed to exercise it most effectively and efficiently. Some attention needs to be devoted to mitigating these risks so that managers, research establishments and departments have the authority considered necessary to achieve desired results effectively.

The Real Challenge — Implementing the *Strategy* and the *Framework*

15.75 The current government initiatives follow some 30 years of attempts to establish and implement a national science and technology strategy or to develop an adequate framework for the management of scientific personnel. We concluded in 1994 that the

Given that the *Framework* will likely result in a more decentralized human resource management regime, some attention needs to be devoted to the issue of accountability for the management of scientific personnel.

The government's tabling of the *Strategy* and the *Framework* represents only the beginning of a long process.

Much remains to be done in many areas and results have yet to be demonstrated.

government had been unable to implement such initiatives successfully.

15.76 We suggested various reasons to explain this lack of success. For example, the initiatives did not always have the support of departments and agencies because they had not been an integral part of the exercise. Other important reasons included the lack of results-oriented, time-phased implementation plans, a lack of leadership and perseverance, and insufficient accountability for results.

15.77 Although departments and agencies have been an integral part of the Science and Technology Review process and are participating actively in the various initiatives currently under way, we believe that the government needs to devote considerable attention to the other elements if it wants to succeed this time.

A need for results-oriented, time-phased implementation plans

15.78 The government's tabling of the *Strategy* and the *Framework* represents only the beginning of a long process. As outlined in this chapter, many of the initiatives undertaken are far-reaching and some of the issues being examined are complex and will take time to resolve. For example, several initiatives in the *Strategy* are still at the "statement" or planning stage. Much remains to be done in many areas and results have yet to be demonstrated.

15.79 The work on human resource issues currently being done by the various work groups cannot be disassociated from the science and technology strategy. The *Strategy* needs to be the cement bringing together people who otherwise may not see the same need to work together. The extent to which the *Strategy* is seen as a real commitment by the government, and its implementation perceived as a real

priority, will affect the degree of commitment by some stakeholders.

15.80 Given the magnitude and the complexity of the task involved, there is a risk that competing issues may detract attention from issues that need to be given higher priority. For example, we have been informed by Industry Canada that a number of task forces of science assistant deputy ministers are being created to study certain aspects of the *Strategy*, such as reporting mechanisms. These people are already involved in various initiatives of the *Framework*. There are limits on the availability of senior management's time, and it is doubtful that a large number of projects involving the same individuals can be carried out simultaneously without some projects suffering delays. In particular, the commitment and support of senior management is crucial not only at the development stage but also throughout the implementation of the initiatives.

15.81 A results-oriented, time-phased action plan has been prepared to govern certain aspects of the *Framework*, but not its implementation. Moreover, implementation plans for various initiatives planned under the *Strategy* have yet to be prepared. Given the magnitude and the complexity of the task involved, we believe there is a need to develop such implementation plans that include key steps, schedules, milestones and resource requirements and that clearly establish accountability for results. At the conclusion of our follow-up work, we were informed by Industry Canada that the Minister of Industry will table a plan for the implementation of a large part of the *Strategy* in the autumn of 1996. Treasury Board Secretariat has informed us that implementation plans will be prepared following decisions concerning the *Framework*.

Leadership and perseverance are needed to bring about change

15.82 A significant investment has been made in the development of the *Strategy*, the related departmental action plans and the *Framework*. For example, people in science-based federal organizations have invested considerable time and effort in the internal review of science and technology activities. The National Advisory Board on Science and Technology has made a thorough assessment of federal efforts in science and technology. During the public consultation process, workshops and conferences on science and technology were held in 31 communities across Canada. More than 3,000 Canadians offered their views and advice to the government.

15.83 The federal government has certainly demonstrated a will to make its involvement in science and technology more effective and relevant. However, as noted in our 1994 Report, that will has not been sustained over the years. Reviews and public consultations have been announced with great publicity, as has the release of public reports. Unfortunately, previous results have not lived up to expectations.

15.84 During our follow-up we noted a substantial level of involvement, support and commitment, if not enthusiasm, from many stakeholders for the actions now being contemplated. Nevertheless, there is a significant level of skepticism, or “prudent optimism” as some have put it, about the implementation of those actions. This skepticism stems mostly from numerous unsuccessful attempts in the past to address the same issues.

15.85 There is a tremendous challenge ahead. We believe that leadership and perseverance will be key ingredients in the

successful implementation of the *Strategy* and the *Framework*. This will require a considerable level of effort at all levels of government — from ministers to scientists. There is also a need for some tangible progress and results to encourage people to maintain the momentum for change. The litmus test of the value of the *Strategy* and the *Framework* will be the degree of acceptance and implementation by the government, the Treasury Board and its Secretariat, and science-based departments and research establishments.

Parliamentary oversight needs to continue

15.86 In 1994, we stated that parliamentarians could play an important role in the Science and Technology Review then under way. We stated that three challenges lay ahead for parliamentarians and the appropriate parliamentary committee:

- ensuring that there is a results-oriented science and technology strategy with real priorities and real direction;
- ensuring that there is a concerted effort to implement the strategy and achieve the intended results; and
- ensuring that a proper accountability structure is put in place.

15.87 We believe that the Standing Committee on Public Accounts, through the hearings held in the spring of 1995 and the presentation of its Sixteenth Report to the House of Commons, has played an important role in ensuring that the government produces a results-oriented science and technology strategy with real priorities and real direction.

15.88 Given the complexity and the magnitude of the task that lies ahead to refine the *Strategy* and implement its various elements, including the *Framework*, we encourage

There is a significant level of skepticism, or “prudent optimism” as some have put it. The litmus test of the value of the *Strategy* and the *Framework* will be the degree of acceptance and implementation by the government, the Treasury Board and its Secretariat, and science-based departments and research establishments.

We encourage parliamentarians through the appropriate committee to monitor the progress made.

parliamentarians through the appropriate committee to monitor the progress made. For example, it would be important to ensure that implementation plans are prepared for both the *Strategy* and the *Framework*. It would also be important to monitor the annual reporting process being implemented for the *Strategy* and to request elaboration if necessary. As mentioned in paragraph 15.42, the Standing Committee on Public Accounts made a request to the Treasury Board Secretariat last year regarding actions being taken on the *Framework for the Human Resources Management of the Federal Science and Technology Community*. We believe that the request contributed to the progress being made in addressing human resource management issues.

Conclusion

15.89 Overall, we are much encouraged by the progress made in addressing the concerns raised in our 1994 Report. We believe that the initiatives being undertaken under the *Strategy* and the *Framework* represent a serious effort — probably the best attempt yet — at eventually resolving some long-identified

issues in the overall management of science and technology activities and the management of scientific personnel. People who are leading or participating in the various initiatives have agreed to devote considerable time and energy to them. In our opinion, this reflects both the importance of the issues and the belief that, indeed, significant change has to take place.

15.90 On a number of issues, however, much remains to be done. Many of the initiatives undertaken are far-reaching, and some of the issues being examined are complex and will take time to resolve. Many other initiatives, notably in relation to the *Strategy*, are still at the “statement” or planning stage. The government will face important challenges in refining its *Strategy* and completing its *Framework*, and in implementing both. This will require considerable leadership and perseverance at all levels of government — from ministers to scientists. Our next follow-up will permit us to determine whether significant progress has been achieved and whether practices have improved for the strategic management of science and technology activities and scientific personnel in federal science-based organizations.



About the Audit

Objective

Our overall objective was to assess the extent of progress made by the government in addressing the government-wide issues raised in Chapter 9 — Overall Management of Federal Science and Technology Activities and in Chapter 11 — The Management of Scientific Personnel in Federal Research Establishments of our 1994 Report.

Scope

For Chapter 9, we focussed our review on *Science and Technology for the New Century — A Federal Strategy*, including the departmental action plans. We met with representatives from Industry Canada, the Treasury Board Secretariat and science-based departments and agencies to obtain an understanding of the context within which the *Strategy* was developed, their perspective on the document and the actions being undertaken for implementing the *Strategy*. We also took into account the March 1996 response of the Minister of Industry to the Sixteenth Report of the Public Accounts Committee.

For Chapter 11, we focussed our review on efforts made at the government-wide level by the Treasury Board Secretariat to address constraints in the current legislative and administrative framework governing human resource management in the public service, as identified by this Office, by science-based departments or by research establishments. More specifically, we focussed on efforts made by the Treasury Board — in its role as the Employer — to develop a framework for managing human resources that would provide for tailor-made and decentralized policies and systems with proper accountability mechanisms to meet the needs of science-based departments and research establishments.

Our work also included an assessment of the project structure put in place and of the terms of reference and the composition of the various project teams, a review of work plans and a preliminary assessment of progress to date. We excluded human resource management practices at the level of departments or research establishments because effective and efficient human resource management will not be achieved unless the “stage is properly set” at the government-wide level. Thus, we did not review or assess the quality of human resource planning in science-based departments or research establishments, nor did we assess the efficiency and effectiveness of downsizing practices in these organizations.

Approach

Our work was based on the results of interviews and discussions with officials from science-based departments and research establishments, Treasury Board Secretariat officials, project team leaders and champions of work groups, and other stakeholders such as officials and staff of the Professional Institute of the Public Service of Canada (PIPSC). We also reviewed relevant documentation and conducted analysis of the information provided by the Treasury Board Secretariat, departments and research establishments to corroborate the information obtained through the interviews.

Audit Team

Denise Coudry-Batalla

Catherine Gendron

For information, please contact Richard Flageole or Jacques Goyer, the responsible auditors.

Appendix

OPERATING PRINCIPLES FOR SCIENCE AND TECHNOLOGY POLICIES AND PROGRAMS

1. INCREASING THE EFFECTIVENESS OF FEDERALLY SUPPORTED RESEARCH

Scientific excellence:

Each federal research facility and program will establish and follow a rigorous schedule for submitting its proposed research activities to an expert review by clients, stakeholders and peers in order to ensure the scientific, economic and environmental excellence of its research.

Relevant lines of enquiry:

All departments and agencies that have not already done so will establish advisory bodies with external representation and ensure that the composition of these bodies benefits from a broad, multidisciplinary constituency.

Full value for money:

Departments and agencies will regularly and systematically assess whether their performance of S&T [science and technology] might be better carried out by others.

Federal departments and agencies will work toward the objective of strengthening the research and technological capability of Canadian firms when deciding which research activities should be conducted in-house and which should be contracted out.

Transfer of knowledge and technology:

The transfer of knowledge and technology is an explicit objective of federal S&T, and departments and agencies will be closely evaluated on their efforts in meeting it.

2. CAPTURING THE BENEFITS OF PARTNERSHIP

Research consortia, alliances and linkages:

All science-based departments and agencies will develop strategies for promoting partnerships and collaborative S&T arrangements with industry, the provinces, universities and other stakeholders.

Federal departments and agencies will develop strategies for increasing interdepartmental collaboration to combine resources and eliminate duplication.

Federal departments and agencies will develop explicit strategies to integrate the social sciences in their S&T activities. Departments will work with the Social Sciences and Humanities Research Council to identify research areas in the social sciences that will better inform policy development in priority areas.

Open-door policy in federal research facilities:

Federal departments and agencies will take measures to improve access to their facilities and encourage an open-door approach to others engaged in scientific research.

3. EMPHASIZING PREVENTIVE APPROACHES AND SUSTAINABLE DEVELOPMENT

Preventive approaches:

Federal departments and agencies will specifically incorporate foresight, risk assessment and prevention practices in their S&T activities to improve their ability to anticipate and address issues before they become problems.

Federal departments and agencies will make greater use of new technologies to improve the design and delivery of their programs and services to Canadians.

Sustainable development through innovation:

The federal government will seek the advice of the National Round Table on the Environment and the Economy in establishing specific targets to help industries and other sectors become significantly more eco-efficient within a generation, and in understanding the implications of those targets for the development of new technologies.

4. POSITIONING CANADA COMPETITIVELY WITHIN EMERGING INTERNATIONAL REGULATORY, STANDARDS AND INTELLECTUAL PROPERTY REGIMES

Modernized regulation:

Federal departments and agencies will aggressively seek opportunities to improve the regulatory systems in which their clients operate in order to reduce regulatory burden and enforcement costs without compromising standards of quality, public safety and sustainable development.

Trade and technology arrangements and international standards setting:

Federal departments and agencies will work with their clients and with a refocused Standards Council of Canada to increase participation in the development and setting of international standards. They will also develop plans for the systematic dissemination of information on new and emerging international standards and other innovation policy issues.

Balancing intellectual property rights and technology diffusion:

The federal government will start immediately to review its intellectual property policy in order to determine what improvements can be made to increase opportunities for commercialization and partnerships with the private sector.

5. BUILDING INFORMATION NETWORKS: THE INFRASTRUCTURE OF THE KNOWLEDGE ECONOMY

Sharing data and analyses:

The transfer of knowledge and the sharing of scientific information and data with Canadian researchers, schools, universities, libraries and industry will be a key function of all federal departments and agencies.

Collaborating in infrastructure development:

Federal departments and agencies will develop information services for dissemination via the Information Highway aimed at encouraging innovation, particularly at the community level.

6. EXTENDING SCIENCE AND TECHNOLOGY LINKAGES INTERNATIONALLY

International alliances and technology partnerships:

As an extension of their domestic mandates, federal departments and agencies will develop explicit plans to promote international S&T collaboration for the benefits of Canadian firms. As well, they will develop specific approaches for gathering and disseminating international S&T intelligence. Our missions abroad will have a key role in this enterprise.

7. PROMOTING A STRONGER SCIENCE CULTURE

Making full use of the Information Highway, departments and agencies will develop action plans to reach out to the community, including young people in schools, universities and colleges.

Source : *Science and Technology for the New Century — A Federal Strategy*, Government of Canada, March 1996

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Report of the
**Auditor General
of Canada**
to the House of Commons

Chapter 16
Treasury Board Secretariat –
Renewing Government Services
Using Information Technology

September 1996

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Using Information Technology



September 1996

This September 1996 Report comprises 8 chapters and a Foreword and Main Points. In order to better meet clients' needs, the Report is available in a variety of formats. If you wish to obtain another format or other material, the Table of Contents and the order form are found at the end of this chapter.

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Cat. No. FA1-1996/2-16E

ISBN 0-662-24997-6

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Chapter 16

Treasury Board Secretariat

Renewing Government Services
Using Information Technology

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Assistant Auditor General: David H. Roth
Responsible Auditor: Nancy Cheng

Treasury Board Secretariat

Renewing Government Services Using Information Technology

Main Points

16.1 Government expenditures on information technology, including capital, operating, personnel and other related costs, represent a major investment of over \$3 billion annually. Using information technology judiciously is recognized as a prerequisite for renewing government services.

16.2 We examined two sets of initiatives relating to the government's *Blueprint for Renewing Government Services Using Information Technology*. We noted that implementation of the Blueprint framework is starting to gain momentum and that visible progress is being made in moving toward shared administrative systems. At the same time, we also identified several areas for improvement. For example, we noted that the Treasury Board Secretariat focusses on reporting the status of flagship projects but not the results they have achieved. Reporting their results could promote departmental participation and build on the Blueprint's existing momentum. There is a need for more timely development and implementation of government-wide network management to support the sharing and interoperability of systems. We observed some lessons that can be learned in the use of technology funds to encourage partnership and innovative use of information technology.

16.3 There has been significant progress since the establishment of the Chief Informatics Officer function at the Secretariat in 1993. The release of the Blueprint framework in 1994 was a key milestone in the move toward a government-wide perspective of technology. Furthermore, the use of an interdepartmental committee structure and related work groups has encouraged dialogue and fostered co-operation in the information technology and user communities within government.

16.4 Yet many challenges remain. To harness and build on the existing momentum of support for service renewal, the Secretariat needs to exercise corporate governance and accountability through strategic oversight, without jeopardizing the consensus-building process that fosters horizontal co-ordination, and co-operation across departmental lines.

Introduction

The Chief Informatics Officer and the Office of Information Management, Systems and Technology

16.5 Government expenditures on information technology, including capital, operating, personnel and other related costs, exceed \$3 billion annually. Information technology not only represents a significant investment by government but also is a prerequisite for supporting the renewal of government services. In the third annual report to the Prime Minister on the Public Service of Canada, the Clerk of the Privy Council referred to the importance of new technologies to help public servants serve clients better.

16.6 In 1993, the Treasury Board established the position of the Chief Informatics Officer (CIO). Supported by the Office of Information Management, Systems and Technology (IMST), the CIO was to provide leadership in aligning the government's information technology with its business activities. The CIO function was intended to serve as a focal point for using information technology and re-engineering in government to increase productivity in the delivery of services and to reduce the cost of administration.

16.7 At that time, there was a recognized need for an overall vision and a technological framework to guide and support the renewal of government administration and services. A framework document entitled *Blueprint for Renewing Government Services Using Information Technology* was developed and released for consultation in early 1994. In June 1994, the Treasury Board endorsed

and approved the document's direction, principles and approach.

16.8 The Blueprint document sets out a vision of renewal to make government services affordable, accessible and responsive through judicious use of modern information technology. It provides for an integrated approach to restructuring program and administrative services across government departments. Exhibit 16.1 shows five aspects in renewing government services. Each of the aspects (called "architectural views" in the document), the related principles and an implementation approach are described in the Blueprint.

16.9 Concurrent with the development of the Blueprint document, many other renewal initiatives were under way, such as process re-engineering, shared systems, locally shared support services and government-wide electronic infrastructure. In addition, a framework entitled "CityPlan" was developed to provide direction for the implementation of the Blueprint. The framework integrated underlying concepts, principles and approaches embodied in the Blueprint and provided for the development of an information management and technology infrastructure to support client-focussed service renewal. The CityPlan was endorsed by the Treasury Board in November 1995 and later circulated to all heads of departments.

16.10 Our audit, three years after the establishment of the CIO function, examined components of two major initiatives to assess the extent to which they provide economical and efficient support for the renewal of government services. Our objective was to identify possible areas where the government could make improvements. The results of this audit may also provide an insight into the CIO's progress in leading the renewal

The Blueprint document sets out a vision of renewal to make government services affordable, accessible, and responsive through judicious use of modern information technology.

of government services using information technology. Further details about the audit are included at the end of the chapter.

16.11 In November 1994, the Office of Information Management, Systems and Technology became a sector in the Financial and Information Management Branch of the Treasury Board Secretariat. Since June 1995, the CIO function, including the IMST sector, has been led by the Branch's Deputy Secretary and Deputy Comptroller General. The responsibilities of the Deputy Secretary and Deputy Comptroller General, as they relate to information management and

information technology, and those of the CIO are shown in Exhibit 16.2.

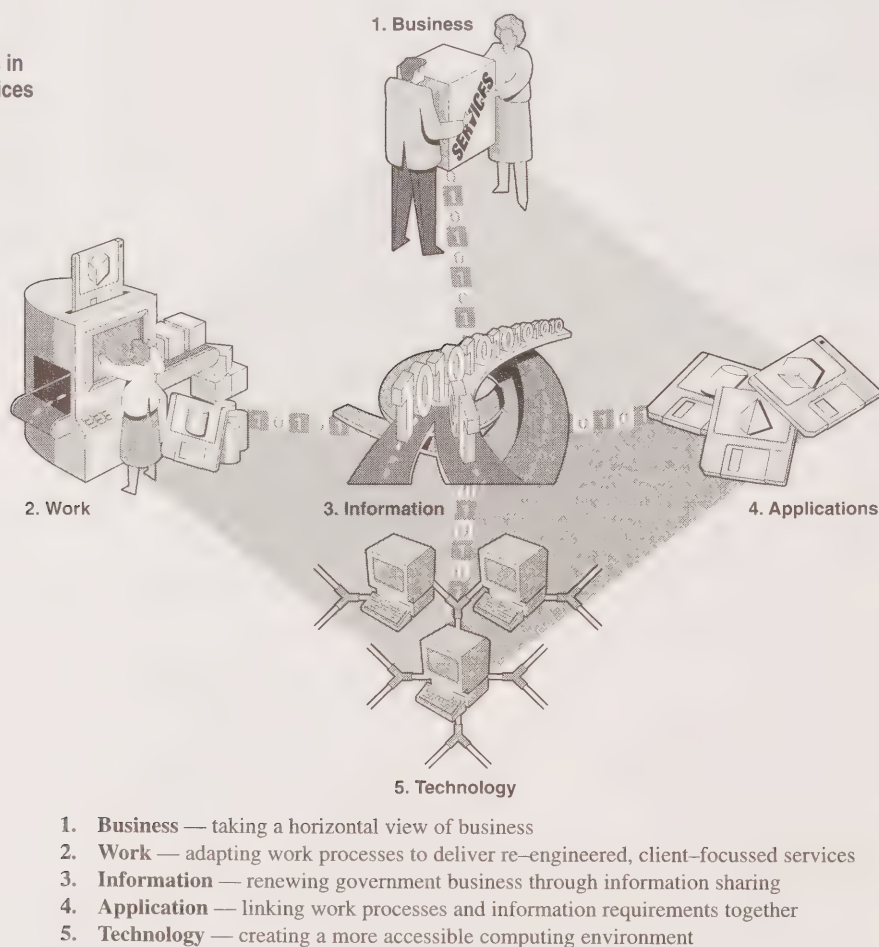
Observations and Recommendations

Infrastructure Development

16.12 The conceptual and implementation frameworks for information technology hold the development of a government-wide electronic infrastructure as a key to service renewal. We reviewed four major components of this initiative:

Exhibit 16.1

The Five Architectural Views in Renewing Government Services



Source: Blueprint for Renewing Government Services Using Information Technology, Treasury Board Secretariat

- the implementation across government of the recommendations in the Blueprint document setting the direction for infrastructure development;
- the program of standards relating to information technology in government;
- the implementation of a common government-wide electronic infrastructure; and
- the use of technology funds intended to facilitate implementation of the Blueprint document and to promote partnering among departments and agencies.

Blueprint implementation is starting to gain momentum

16.13 The Treasury Board Secretariat focussed on three areas of action to implement the Blueprint — innovative service delivery; modernized internal administration; and government-wide electronic infrastructure.

16.14 To facilitate the implementation, the Secretariat identified in each of the three areas a number of flagship projects intended to set the direction for service

renewal and to demonstrate progress and results.

16.15 Some projects were launched by the IMST; some were initiated by other government departments and agencies. Initially, in late 1994, 12 flagship projects were identified. By March 1996, a total of 18 flagship projects were being tracked. Of the six new projects, five relate to developing a government-wide electronic infrastructure. Almost all of the new projects are led by the Secretariat.

16.16 Periodically, IMST staff seek an update on the progress of the projects against their milestone dates; the information serves as the basis for the Secretariat to report progress to the Treasury Board. Moreover, at various interdepartmental committees involving senior management of departments and agencies, IMST has been presenting these flagship projects to demonstrate progress and to help generate momentum for the Blueprint.

16.17 The Blueprint document calls for government departments to use it in planning and implementing their own service renewal. Specifically, it states:

Acting as a focal point for government in using information management and technology to achieve productivity increases in service delivery and to reduce the cost of administration, the Chief Informatics Officer and the Information Management Systems and Technology Sector are responsible for:

- developing policies and standards for information management (IM), information technology (IT) and related telecommunications activities;
- exercising functional direction and providing support for departmental IM/IT and related telecommunications activities;
- directing the re-engineering of government administrative processes and leading their cross-functional integration;
- establishing a framework and actively supporting the re-engineering of the government's program delivery mechanisms;
- supporting the development of the IT community and the implementation of IM/IT skills across government; and
- representing the government in dealing with the private sector to encourage the transfer of skills and to promote private sector involvement in government IM/IT activities.

Exhibit 16.2

Responsibilities of the Chief Informatics Officer and the Information Management, Systems and Technology Sector

Source: 1994–95 Part III of the Estimates, Treasury Board Secretariat

We noted that most departments have begun to adopt the basic principle of implementing shared systems.

Departments will use the Blueprint in planning and implementing their own internal renewal activities. They will reflect their planned approach to implementation in such planning instruments as annual operational plans and information management plans, starting in 1994–95.

16.18 We selected a number of departments and reviewed their 1995–96 departmental business plans and their most recent information management plans. We found that, to a varying extent, departments have generally moved to incorporate Blueprint principles in their plans for service renewal.

16.19 In some cases, there was a clear indication that the conceptual framework in the Blueprint has been adopted and used. Departmental initiatives involving information technology are specifically related to Blueprint principles. For example, one department has developed a long-range plan to provide simpler and more timely service delivery through information systems that are open, accessible, flexible and interconnected. These principles are consistent with those set out in the Blueprint. Although use of the Blueprint in planning appeared in a couple of cases to be at an initial stage, we noted that most departments have begun to adopt the basic principle of implementing shared systems, a major concept in modernizing government administrative services.

16.20 The Blueprint document presents a conceptual framework, setting out the government's vision, direction and principles for using information technology to support service renewal. In our view, the implementation of the Blueprint is starting to gain momentum.

Monitoring would foster implementation but is lagging

16.21 Through strategic planning and operational review, departments prepare business plans and submit them annually to the Treasury Board Secretariat. The Secretariat uses the business plans as a primary vehicle for interacting with departments. According to the Secretariat, teams are formed to review the plans and to provide strategic oversight. As applicable, the IMST staff form part of these teams and address components of the plans involving information technology.

16.22 However, there is a need for a more concerted effort to monitor the development of technological direction in departments. Such monitoring would provide a basis for selective and strategic involvement with departments by the IMST to foster adoption of the technological direction that has been set out or to identify barriers and impediments that need to be addressed. Departments prepare information management plans as part of the planning process to outline their strategic direction for information management and technology. The IMST could use these plans, or other available documents that include a comprehensive orientation to information technology, as a starting point for direct communication with individual departments to facilitate use of the Blueprint framework.

16.23 Reporting the progress of flagship projects provides a good vehicle to communicate achievements to date and to build momentum for using the Blueprint framework. In reviewing the progress report, we noted that the updates generally focussed on the status of the various flagship projects against project

milestones. However, the reports did not highlight results or benefits that were achieved.

16.24 In our opinion, the reporting of results would solidify support and could generate further buy-in and commitment from departments. The current approach runs contrary to the objective of using the flagship projects to demonstrate results. Although some projects are in early phases, it would be feasible in about one third of them to start capturing results and benefits derived.

16.25 A critical element of ensuring a government-wide electronic infrastructure is to adopt and comply with standards that permit various components to communicate and interoperate. Since 1987, the Treasury Board Secretariat has had in place a program for the Treasury Board Information Technology (TBIT) standards, promulgated as part of Treasury Board policies. In implementing information technology, departments and agencies are required to comply with these standards.

16.26 An internal review was undertaken in 1995–96 to determine whether departments were effectively making reference to the TBIT standards in their acquisitions, and whether industry was demonstrating its support of those standards by supplying goods and services that conformed to them. Among its observations, the review found that departments generally were not citing TBIT standards when they acquire information technology, but the common procurement process was forcing some level of standardization. The review also questioned the relevance of the standards. It recommended an examination of both the existing standards and the method of monitoring departments' compliance with them.

16.27 The IMST has sought Treasury Board support for refocussing the program of TBIT standards. In April 1996, the Board endorsed the new direction, emphasizing “standards as solutions; standards as appropriate”. In the new direction, the standards are to become more relevant to government operations and more flexible, embracing de facto standards of industry in addition to those sanctioned internationally.

16.28 However, the implementation plan remains at a policy level and has yet to address the specific issue of ensuring compliance. Given the significance of the standards, it is important that the Secretariat devise an approach to monitoring so that it can be aware of implementation practices for information technology and can take appropriate action to ensure compliance.

Government-wide network management has yet to be developed and implemented

16.29 A key principle of the Blueprint framework is interoperability and connectivity, the principle of permitting information technology components to work together interactively. A government-wide electronic infrastructure comprising electronic networks and other computing services is a key to the renewal of services to the public. It is critical to supporting concepts for new modes of service delivery such as an expert service centre, where the public could receive services at a single point of contact (Exhibit 16.3).

16.30 Most departments have put in place electronic networks but have done so to serve their own specific operational requirements. As a result, there has been a proliferation of independent telecommunications networks and computing services. Many are based on incompatible technologies, making it

The implementation plan for the Treasury Board Information Technology standards remains at a policy level and has yet to address the specific issue of ensuring compliance.

difficult to communicate and interoperate government-wide. In addition, it has been recognized that smaller departments may not have the necessary resources or expertise to take advantage of advances in the industry.

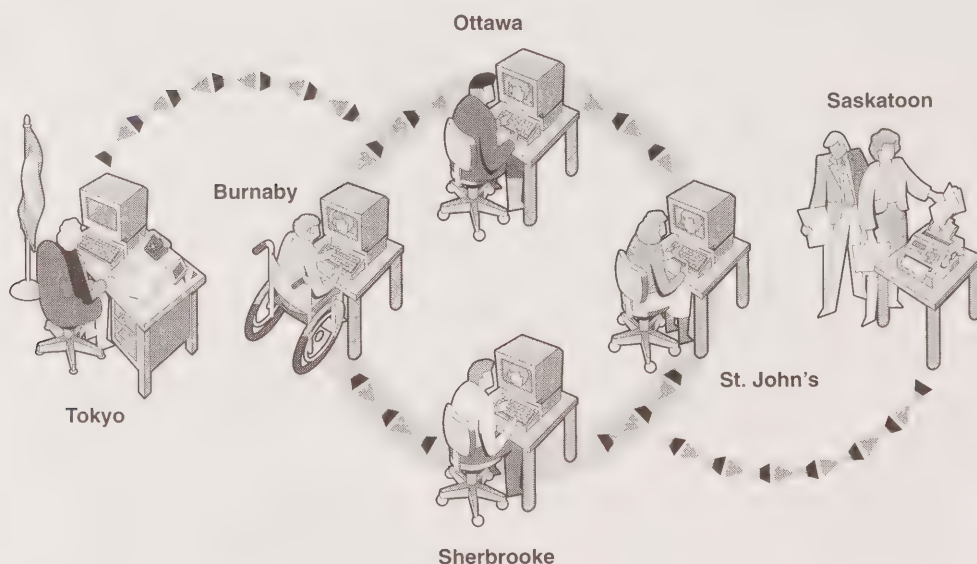
16.31 In late 1994, the Secretariat endorsed a number of infrastructure initiatives. They included establishing government-wide connectivity in the use of electronic messaging, an electronic directory, and a private high-speed fibre optic network for the National Capital Region. A separate and broader initiative was to establish common telecommunications and network management services that would support interoperability across the government.

16.32 The Government Telecommunications and Informatics Services (GTIS) of Public Works and

Government Services Canada has been responsible for the specific initiatives. We observed that government-wide electronic messaging is now in place through the Government Message Handling Service, connecting over 200,000 desktop computers across Canada. A government-wide electronic directory, through the Government-wide Electronic Directory Service of GTIS, was formally introduced in June 1996. According to GTIS, a government fibre optic network has been implemented in the National Capital Region. We were advised that this dedicated government service, provided under contract, is not being used fully due to market forces and competitive alternatives. The GTIS indicated that it has recently agreed to transfer the contract to the primary contractor, and work is under way to enhance service and exploit the value of the contract.

Exhibit 16.3

An Expert Service Centre



Through the use of computer technology, internal and external clients can access experts in government directly and quickly, reducing the need to duplicate similar services and improving the rate and success of client response.

Source: Blueprint for Renewing Government Services Using Information Technology, Treasury Board Secretariat

16.33 In 1995, the Secretariat and four major departments developed a proposal to seek joint action in network management, using a phased approach. The proposal recommended forming cluster groups around several major departments to allow smaller departments to share and integrate existing networks, eventually moving toward a government-wide integrated network. In June 1995, the Secretariat and the four departments formally agreed to the proposed joint action. In July 1995, a steering committee on network management was established. Subsequently, in November 1995, Treasury Board endorsed the implementation of a government-wide integrated network with an intermediate target of three cluster arrangements involving the four departments.

16.34 In the fall of 1995, the Canadian Radio-Television and Telecommunications Commission rendered a decision that deregulated non-dominant carriers of telecommunications services, to foster competition. The decision triggered an immediate need to review and revise the government's process for procuring those services. The focus of the network management committee shifted to the procurement issue. In May 1996, a new procurement process was being developed, with testing planned for August 1996 and implementation scheduled for early 1997.

16.35 When we completed our audit in May 1996, the cluster arrangements approved by the Treasury Board were not proceeding as planned. In July 1996 the Secretariat advised us that, working with departments, it is in the process of defining and articulating a future vision of a common network infrastructure, including establishing a governance regime and developing an implementation

plan. However, it was not evident if and how the cluster arrangements were to proceed. The procurement issue is being addressed and progress is being made in connecting desktop computers through electronic messaging and electronic directory services. However, we noted little visible movement toward the implementation of common network management services to support the sharing and interoperability of systems across the government.

Management of technology funds needs to be improved to fully realize the benefits

16.36 It has long been recognized that technology investment funding is often needed to promote innovative use of technology and partnering among departments and agencies. We examined the use of two such technology funds — the Informatics Partnership Fund and the Informatics Infrastructure Fund.

16.37 In October 1991, the Treasury Board approved the establishment of a \$10 million Informatics Partnership Fund. The purpose of the Fund was to use start-up funding to promote increased sharing and collaboration among departments and/or the private sector in testing innovative uses of information technology in government programs and administrative processes. Submissions to the Secretariat were evaluated case by case, and the funding granted to the sponsoring departments was non-repayable. In total, 16 projects were funded with over \$9 million. The Informatics Partnership Fund was ended on 31 March 1996.

16.38 We observed that many of these projects involve innovative use of information technology. We also noted some instances of inconsistency in approving proposals for use of the Fund. For example, specific criteria for approval

The focus of the network management committee shifted to the procurement issue.

We observed that many of the funded projects involve innovative use of information technology.

included a condition that funds would be “awarded only once for a project since the intention was to provide seed money only.” In one instance, a sponsoring department received funding twice for the same project. Yet a separate project co-sponsored by two departments was refused funding for its second phase. The criteria also specified that “preference [would] be given to departments applying for the first time as opposed to past recipients.” We noted that two departments received funding on five and four occasions respectively.

16.39 In addition, funding requests were submitted for two projects that were similar in nature, both relating to shared systems approved by the Treasury Board Secretariat. One request was not supported by the Secretariat; the other was approved. The files did not contain an adequate explanation for the different treatment. We also noted that the funds for the project that was approved were provided to the Secretariat rather than the sponsor department.

16.40 Moreover, there was no evidence that the IMST has followed up on a key condition of the Informatics Partnership Fund. The general criteria stated:

There must be a review at the end of the project that will be shared with the government information technology community. The sponsor must agree to the dissemination of this information, so that there is government-wide sharing of the knowledge.

16.41 There were no progress reports on file, nor was there evidence that project results were being shared. We followed up with some sponsor departments and ascertained that the funding did contribute to developing the use of information technology. However, there was only

limited evidence that the objective of sharing was being served.

16.42 Our interviews with departments also identified two deterrents to applying for use of the Fund. First, the submission process was onerous and lengthy. Project sponsors were required to seek approval in their own departments, followed by a formal submission to the Treasury Board. Upon its acceptance, financing was provided but at times quite late in a fiscal year, leaving little time to apply the funds. Second, the funding was designed to support project planning and definition. Projects received an average of about \$500,000 in financing. The majority of the funding needed — for project development and implementation — remained the responsibility of the sponsor department.

16.43 Further, we found that there had been a significant turnover in fund management at IMST. In the 12-month period ended March 1995, the Informatics Partnership Fund was managed successively by five different IMST staff members. The Secretariat advised us that there had been internal reorganization during that time. The frequent turnover in fund management eroded corporate memory. It was not efficient for ongoing interaction with existing and would-be participants and it might have limited the IMST's ability to provide information supplementary to that contained in the files.

16.44 Our follow-up with departments shows that the Informatics Partnership Fund has contributed to advancing the use of information technology. However, we believe that lessons can be learned from its experience and applied in administering other technology funds to maximize the benefits of using information technology in government.

16.45 The Informatics Infrastructure Fund was approved by the Treasury Board

in January 1995 to support departments in undertaking projects to move toward the government-wide information technology infrastructure and architecture envisioned in the Blueprint. The Fund has a budget of \$15 million per year, amounting to \$60 million over four years starting in 1995–96. Unlike the Informatics Partnership Fund, funding from the Informatics Infrastructure Fund requires a payback through a reduction in the department's future expenditure reference level.

16.46 The Fund was not widely used in its first year. As of May 1996, two projects totalling \$4.5 million over four years had been approved; five other enquiries were received but have not proceeded for various reasons. In the first year of operations, only \$100,000 in total was allocated. Of the \$15 million budget for 1995–96, \$10 million was reprofiled and extended to 1999–2000.

16.47 In today's climate of continuing fiscal restraint, many departments are reluctant to commit to a payback requirement that would reduce their future expenditure reference levels. Their concern is that the reduction may become permanent. We understand that this payback requirement was a significant factor in the withdrawal of one project submission.

16.48 However, the payback requirement was not evident for the two projects that were approved. In the first project, payback will be effected through means other than a reduction in the future expenditure reference level. This project was submitted by a department working with several other departments and the private sector to develop a technological product for use across government. For the second project, no payback was required. The latter project funds the Secretariat's project office to direct and

co-ordinate activities of a government-wide strategy. Although this project met criteria for funding, it is not entirely clear that it conformed with the Fund's purpose of accelerating the attainment of the government-wide information technology infrastructure and architecture set out in the Blueprint. In our view, lack of clarity causes confusion and potentially reduces the effectiveness of the Informatics Infrastructure Fund.

16.49 The Secretariat indicated that it requires flexibility in interpreting terms and conditions of the funds. We were also advised that the IMST is reviewing the payback requirement and the terms and conditions of the Informatics Infrastructure Fund. We believe that the review would benefit from the experience of both technology funds; clarification and communication of the Informatics Infrastructure Fund's objective, terms and conditions are essential to fully realize the benefits.

Shared Systems

16.50 Today, there are numerous individual departmental systems and sub-systems being used for common administrative processes. The sharing of administrative systems could provide a major opportunity to reduce overhead costs and to streamline and improve administrative services.

16.51 The shared systems initiative is a key element of renewing the government's internal administrative systems. The Blueprint refers to the concept of shared systems as one of the guiding principles of service renewal. The initiative is one of the flagship projects used by the IMST to demonstrate the progress and results achieved with the Blueprint.

16.52 The merit and significance of the shared systems concept were recognized well before the Blueprint was promulgated

in 1994. The Council for Administrative Renewal, comprising senior officials from various departments and agencies, was formed in 1991 to advise the Treasury Board on ways to reduce the cost of administration and improve support for delivery of government services. The Council established a Shared Systems Working Group, and the Salary Management System cluster was approved as a pilot project in 1992.

16.53 In 1993, the Program Review Implementation Board approved the shared systems initiative and a proposed set of targets. Various committee structures were formed in 1994, including the Committee on Government Systems (a sub-committee of the Council) and cluster work groups and committees.

16.54 The initiative has been endorsed by the Treasury Board and is supported by the Deputy Ministers' Task Force on the management of overhead services. In its report of January 1996, the Task Force reaffirmed the direction and goals of the initiative.

Visible progress is being made toward shared administrative systems

16.55 Since 1993, various administrative areas have been identified as offering a potential for sharing systems across government. In particular, cluster groups have been established for administrative systems in five areas — financial management, human resources management, materiel management, salary management and travel administration. In addition, three new areas are under review and development: business planning; management of executive information; and management of documents and records.

16.56 The work of the cluster groups is most advanced in the areas of financial

management and human resources management. At the end of May 1996, seven financial and three human resources systems had been approved.

16.57 After consultation and discussion with the Committee on Government Systems and other stakeholders, the IMST proposed strategies and actions to the Treasury Board for implementing the shared systems initiative, and received approval in April 1996.

16.58 The financial management area has been identified as fully mature and its seven systems are deemed to be sufficient to meet the needs of all government departments. The Treasury Board approved limiting departments' selection to one of the seven financial management systems. The Secretariat advised us that each department and agency will be asked to specify its choice by December 1996 and to provide a plan for migrating its systems. Departments seeking to use a system other than the approved clusters would have to justify their position.

16.59 If the departments limit their choice to the seven approved systems, this aspect of the shared system initiative will represent a move from more than 30 financial systems in the government to seven. With user acceptance and proper implementation, the initiative has the potential to generate substantial savings by reducing duplication of effort and the cost of developing and maintaining individual systems.

16.60 In IMST's view, the human resources area is not fully mature and there may be a need for additional systems in this area to be able to serve all departments and agencies. The IMST expects to seek Treasury Board approval when there has been acceptance that the clusters collectively are capable of serving the needs of all departments.

With user acceptance and proper implementation, the initiative has the potential to generate substantial savings.

16.61 The major cluster in the area of human resources management is the Human Resources system of PeopleSoft Inc. (PeopleSoft). Unlike the financial systems, where departments are to join existing approved clusters, the IMST has taken a lead role in acquiring this commercial off-the-shelf application for use government-wide (Exhibit 16.4). As of May 1996, 17 departments, including some large departments, had committed to using PeopleSoft and have become part of the cluster group. The PeopleSoft cluster has the potential to become the government system for human resources management.

16.62 In summary, the direction of the shared systems initiative is consistent with the vision and principles articulated in the Blueprint. At this time, we have observed visible progress toward sharing administrative systems in government.

Clustering is fostering horizontal co-ordination

16.63 Under the clustering approach, departments and agencies participate as members of the cluster group to identify administrative systems and discuss means for sharing among member departments. Participants are supposed to share not only the associated risks and costs but also the benefits and results.

16.64 We observed that the approach builds synergy and enthusiasm among participants in seeking a common solution to a shared set of issues. The process helps to build consensus, as decisions generally affect all participants. It also encourages cluster members to place the common interest ahead of their specific departmental needs.

16.65 The PeopleSoft cluster demonstrated that many departments can work together to resolve common issues

We observed that the clustering approach builds synergy and enthusiasm among participants in seeking a common solution to a shared set of issues.

- **Government-wide contract concluded within one year after formation of cluster group**

A cluster group for shared systems in the human resources management area was formed in September 1993 with the objective of acquiring commercial off-the-shelf applications for use in government. The Human Resources system of PeopleSoft Inc. was selected and endorsed by the group as a shared systems cluster. In September 1994, the Treasury Board Secretariat concluded a \$5.1 million contract with PeopleSoft Inc., acquiring a software license and support for the use of its Human Resources system by all participating government departments. The contract contains a provision to permit the use of the system by all other departments and agencies through amendments effected within 10 years of signing the original contract.

- **Cluster group efforts led to the development and release of a Government of Canada version of the application**

By October 1995, PeopleSoft Inc. had released its commercial version 5.0 and its first Government of Canada version based on certain legislative requirements. Through co-operative efforts, the cluster group identified other requirements and specifications that are unique to government. In May 1996, we were advised that the latest release of the Government of Canada version included a Work Force Adjustment module, a Leave Management module and some other enhancements. Further enhancements to the Government of Canada version of the PeopleSoft system are expected.

As of May 1996, 17 departments representing 220,000 full-time equivalents were participating in the cluster. Most of them are working toward implementing the PeopleSoft system.

Exhibit 16.4

The PeopleSoft Experience – Examples of Progress

(Exhibit 16.4). Working originally with 15 departments, the cluster group was able to specify common government requirements. As a result, a government version of PeopleSoft has been developed and will continue to be supported by the software supplier in its future upgrades.

16.66 Consensus building is essential in today's government environment.

Departments and agencies are re-examining their programs and services to the public and are seeking ways to consolidate and streamline service delivery. In our view, the clustering approach can foster the consensus needed for horizontal co-ordination across departments.

Targets and results need to be better defined

16.67 When the Program Review Implementation Board approved the shared systems initiative in October 1993, it also approved certain related targets. Specifically, the initiative is expected to:

- reduce, over five years, the number of major administrative systems from 60 personnel, 30 financial and 30 materiel systems to 3, 4 and 3 systems respectively;
- migrate 80 percent of major departmental systems to shared systems within five years;
- ensure that major shared systems interconnect by September 1996; and
- achieve \$800 million in savings to departments and agencies over five years.

16.68 Progress is being made toward meeting the first target of reducing the number of systems in the three administrative areas. There are three approved clusters for human resources management systems. The number of approved financial management systems has grown from four to seven. The IMST

advised us that the seven systems will be able to serve all departments, rather than four shared systems serving 80 percent of the departments. At present, there are two approved cluster groups for materiel management. According to the IMST, its medium-term strategy is to move toward integrated financial and materiel management systems.

16.69 However, IMST confirmed that most targets would not be achievable by late 1998. In particular, with the exception of some integrated financial and materiel management systems, major shared systems will not interconnect by September 1996. It is important that the targets be updated, clearly defined and communicated to reflect present circumstances. Reasonable and realistic targets can provide a basis for measuring progress and performance and can help guide implementation efforts.

16.70 The IMST has been using cost avoidance as the measure of cost savings. It attempts to estimate the costs that would have been incurred without the sharing of administrative systems. The IMST advised us that the measure was chosen in order to not duplicate savings identified by departments in meeting Program Review targets. We are concerned that the use of only subjective measurement such as this may not be sufficiently meaningful or persuasive to demonstrate results of the initiative. There is a need for better measurement to estimate and compare the costs of acquisition, implementation and ongoing maintenance of shared systems with those of existing systems across government.

16.71 The shared systems initiative originated under the guidance of the Council for Administrative Renewal, was endorsed by the Deputy Ministers' Task Force on the management of overhead services, and was approved by the

Treasury Board. Furthermore, it has the support of the community in principle. However, no business case has been made to assess the costs of investments against their expected benefits to the government as a whole. Nor is there any indication of what results the initiative would achieve and how those results would meet the overall objectives of reducing overhead costs and improving support for service delivery.

16.72 For example, the approved PeopleSoft human resources cluster is not supported by a corporate business case. Only 5 of the 17 participating departments have prepared separate business cases. In various discussions, the IMST has acknowledged that the benefits of common initiatives may not accrue evenly among departments and agencies, but emphasizes that benefits ought to be considered at a corporate level. Thus, it is important that an enterprise-wide business case be developed for each cluster to identify costs and benefits, both tangible and intangible, and to demonstrate how corporate objectives are being met. Participating departments could then conduct supplementary analyses, focussing on the implications for their own operations.

16.73 Gaining the commitment of departments to participate in the initiative takes time. A good corporate business case would demonstrate the value of the undertaking. Supplementary departmental analyses could highlight areas where significant payback can be expected. Such information could encourage participants to commit to the partnership, as departments could redeploy resources from reduced overhead services to delivering their programs.

16.74 In our view, revising targets and setting out expected results of the initiative would improve its

implementation and serve as a basis for performance measurement and accountability.

The concept of shared accountability triad carries risks that have to be managed

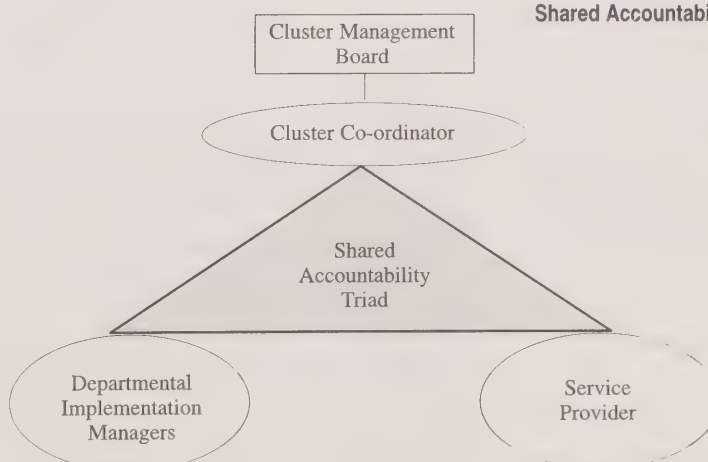
16.75 The management framework approved in April 1996 as part of the shared systems initiative uses the concept of a shared accountability triad. The Treasury Board Secretariat provides leadership by developing policies and setting priorities, approving clusters and managing enterprise investment funding. Each of the clusters will be managed by a cluster management board with a shared accountability triad of a service co-ordinator, departmental implementation managers and the service provider (Exhibit 16.5).

16.76 The cluster management board will include representatives from all participating member departments and agencies. Its role involves planning, problem resolution and decision making. The cluster co-ordinator supports the

A good corporate business case would demonstrate the value of the undertaking.

Exhibit 16.5

Shared Accountability Triad



Source: Information Management, Systems and Technology Sector, Treasury Board Secretariat

The new framework could run the risk of delays and inefficiency, particularly when the cluster is in a development or implementation stage, where there is usually a high level of activity.

management board and co-ordinates the joint efforts of member departments.

16.77 As indicated in paragraph 16.65, the PeopleSoft experience has demonstrated the strength of clustering in building consensus. However, it also provides other lessons that can be learned. Preliminary findings of a review commissioned by the Secretariat and completed in April 1996 show a need to strengthen the management framework for PeopleSoft. A primary concern is the lack of direction and guidance from the PeopleSoft Board of Directors (Exhibit 16.6).

16.78 In the fall of 1995, the management board approved in principle a government joint internal audit of the PeopleSoft project. In January 1996, the internal auditors from the departments involved prepared a draft set of terms of reference for the audit. However, the management board remained inactive until late April 1996. In the absence of the board's sanction and support, the planned audit did not proceed. In the meantime, there were concerns in the community that departments might be customizing their PeopleSoft systems considerably, which could result in 17 different versions of the

human resources management system. Customization, if not checked, would erode the intended savings and benefits of the shared systems initiative.

16.79 The new management framework addresses some of the management issues by defining the respective roles of the parties involved. Yet, depending on the cluster, some management boards could involve 20 member departments. A sizable committee that meets regularly would easily fill a steering or advisory role. However, it is not certain whether these management boards could be sufficiently responsive and accessible for decision making and problem resolution. In addition, the cluster co-ordinator's role is to co-ordinate cluster activities between member groups and the service provider as well as joint efforts undertaken by the cluster. The responsibility for day-to-day management is to be left to the triad, while departments are to continue to be responsible for operating their systems. This new framework could run the risk of delays and inefficiency, particularly when the cluster is in a development or implementation stage, where there is usually a high level of activity.

16.80 The new management framework carries risks that could undermine the

Exhibit 16.6

Some Lessons Learned from the PeopleSoft Experience

In early 1996, the Treasury Board Secretariat commissioned a checkpoint review to assess the implementation plan and activities relating to the PeopleSoft system and to offer recommendations concerning the cluster approach to managing the application.

The preliminary findings of the review supported the selection of the PeopleSoft application for government and highlighted other benefits of sharing systems. They also pointed to a number of lessons learned. Specifically, suggestions were made to improve the management framework. A primary concern, the review noted, was the lack of direction and guidance from the Board of Directors and the absence of a full-time project director. The PeopleSoft Board of Directors met five times between November 1994 and April 1996.

Although it did not highlight this as a significant concern, the review noted that modifications and customization at departments were being contemplated. The review also estimated the cost of implementation to range from \$60 million to \$100 million over and above the software licence acquisition costs of \$5.1 million. In addition, ongoing operating costs were estimated at \$20 million annually.

benefits of the shared systems initiative. In putting the framework in place, the Secretariat needs to continue its leadership role by retaining oversight, monitoring progress and taking joint action with departments as appropriate to further the interests of the government as a whole.

Progress Made and Challenges Ahead

Significant progress has been made since 1993

16.81 The development and promulgation of an information technology framework through the publication of the Blueprint is a key milestone in moving the government toward technology-based renewal of services. Supported by the CityPlan and many flagship projects, the Treasury Board Secretariat has been providing leadership and setting the direction for the use of information technology in government. We observed that momentum for change is starting to build in the information technology community of government.

16.82 An equally important but subtle accomplishment is the synergy and co-operation that is being generated among departments. In recent years, through various audit reports, we have expressed repeated concern about insufficient co-ordination and co-operation among government departments on operational and policy issues.

16.83 Under the auspices of the Chief Informatics Officer, the Treasury Board Secretariat has been shifting the focus of the information technology community in government from an individualistic, vertical, departmental environment to one with a horizontal, corporate,

enterprise-wide perspective. Facing shared issues and seeking common solutions, departments are encouraged to embrace horizontal co-ordination rather than concentrating on individual departmental needs that may not be essential or significant at a government-wide level.

16.84 In particular, the interdepartmental committee structure and various related work groups can facilitate dialogue and foster co-operation across government. The committees and work groups involve staff at the working level as well as senior management, including deputy ministers.

16.85 The fiscal climate has demanded a fundamental review of government's role in providing service to the public. Judicious use of information technology can become a forum for discussion and act as a springboard for an integrated approach to program delivery. It is encouraging to observe a cultural shift toward horizontal co-ordination, and co-operation that crosses departmental lines.

Challenges to overcome in order to realize benefits

16.86 In auditing the two major initiatives, we noted challenges ahead that need to be met before the government and, in turn, the public can realize the full benefits of using information technology to renew service delivery.

16.87 The Secretariat set the strategic direction for using information technology in government. We found a general lack of focus on measuring results and providing information on outcomes. The reporting of results to demonstrate the success and value of the undertakings could promote earlier commitment and help deflect reluctance by departments to participate in interdepartmental partnerships.

It is encouraging to observe a cultural shift toward horizontal co-ordination, and co-operation that crosses departmental lines.

From the two initiatives we audited, it is not evident that the Secretariat has the information or the assurance that departments are following the functional direction it has set.

16.88 We recognize that in some cases it might be difficult to measure results. Nevertheless, we believe that better attempts can be made. Many large companies in the private sector have a multitude of holding companies and/or branch operations involving multiple business lines. Through identification of tangible and intangible benefits of investments, undertakings receive endorsement and are carried out. The actual benefits and the end results are then measured against the cost of the investments.

16.89 Monitoring actual outcomes of initiatives is an integral part of measuring performance against objectives. It provides the information to help assess benefits of the initiatives against their costs and to guide decisions. Measurement of results also serves as the basis for accountability to Parliament.

16.90 At a time when acceptance of the Blueprint is starting to build and many initiatives are under way, the biggest risk is a failure to sustain the momentum. This risk could be mitigated through stronger exercise by the Treasury Board Secretariat of its oversight role. From the two initiatives we audited, it is not evident that the Secretariat has the information or the assurance that departments are following the functional direction it has set. The committee structure and the work groups have been effective in fostering horizontal co-ordination. But their roles do not generally involve delivering measurable results.

16.91 The government has undergone major reorganizations since 1993. The role of the Treasury Board Secretariat and its relationship with departments and agencies have been evolving since then. In our November 1995 Report, we commented on the need for balancing centralized and decentralized

administration. In this chapter, we are not advocating centralization or a highly controlled environment. Rather, the Secretariat needs to exercise corporate governance and accountability by playing a strategic oversight role while continuing to facilitate consensus building among departments.

16.92 The challenge of striking the right balance is not an easy one. However, for purposes of corporate governance and accountability and to realize the full benefits of initiatives, it is important to ensure that the policy and direction set by the Secretariat are implemented in partnership with departments and agencies.

16.93 Where policy and direction for the use of information technology have been set and promulgated, the Treasury Board Secretariat should track implementation at a strategic level to measure the results against government-wide objectives and take corrective actions as appropriate.

16.94 The Secretariat should ensure that government-wide network management is developed and implemented on a more timely basis to support interdepartmental operability for program and administrative service renewal.

16.95 The Secretariat should better define expected results of strategic initiatives involving information technology and relate them to the overall government-wide objectives, to encourage partnership among departments and to serve as a basis for performance measurement and reporting.

Treasury Board Secretariat's response:
The Treasury Board Secretariat recognizes the importance of information technology. It is striving to further improve on the positive contribution information and

technology have made, and are expected to continue to make, to the government renewal agenda. We welcome the Auditor General's comments in this regard.

The Treasury Board Secretariat will take specific steps to deal with recommendations for improvement by strengthening its strategic oversight function and by working with departments,

which ultimately have the responsibility for making decisions on the deployment of information technology. It intends to continue to provide leadership through the Chief Information Officer to realize the promise of information technology-based renewal, in partnership with the government IT community and the private sector.



About the Audit

Scope and Objective

We audited selected components of two major initiatives in the Treasury Board Secretariat's implementation of its conceptual framework for the use of information technology to renew program and administrative services. The audit objective was to assess the initiatives and the extent to which they provide economical and efficient support to the corporate objective of government service renewal, with a view to identifying areas for improvement.

Specifically, in reviewing the infrastructure development initiative, we covered the implementation of the Blueprint framework and the Treasury Board Information Technology Standards program, the implementation of a government-wide electronic infrastructure and the use of technology funds. For the shared systems initiative we reviewed its progress, including the approved cluster of the Human Resources system of PeopleSoft Inc., but we did not audit the PeopleSoft application or its implementation across government. We have also not audited the seven approved financial management systems or the related Financial Information Strategy.

We conducted our audit primarily at the Information Management, Systems and Technology Sector of the Secretariat. For a stakeholder perspective, we also interviewed staff of some departments and reviewed planning instruments from several departments.

Criteria

Where appropriate, the observations in the chapter reflect the audit criteria we used. In general, we looked for the following:

- The initiatives and the related activities should support the business priorities of government and be consistent with the government's overall vision and strategy for information technology.
- The objectives and expected results of the initiatives should be clearly identified.
- There should be appropriate monitoring and reporting on progress toward the achievement of objectives and results for the initiatives.
- Procedures should be in place to ensure economical and efficient use of funds in support of technology initiatives.

Audit Team

Greg Boyd
Joyce Ku

For information, please contact Nancy Cheng, the responsible auditor.

Report of the Auditor General of Canada to the House of Commons – 1996

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Report of the
**Auditor General
of Canada**
to the House of Commons

Chapter 17
Human Resources Development Canada –
Canada Pension Plan: Disability

September 1996

**Report of the
Auditor General
of Canada
to the House of Commons**

Chapter 17
Human Resources Development Canada –
Canada Pension Plan: Disability



September 1996

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Cat. No. FA1-1996/2-17E

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Chapter 17

**Human Resources
Development Canada**

Canada Pension Plan: Disability

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Assistant Auditor General: David Ratray
Responsible Auditor: Louis Lalonde

Human Resources Development Canada

Canada Pension Plan: Disability

Main Points

17.1 Our audit examined the adequacy of management practices related to assessing eligibility for Canada Pension Plan (CPP) Disability benefits and measurement and reporting of achievement of objectives. Our observations and recommendations for improvement are reported in this chapter.

17.2 Over the past 10 years, CPP Disability benefit payments have more than tripled, climbing from \$841 million in 1986–87 to close to \$3 billion in 1995–96. The number of beneficiaries has almost doubled over the same period, from 155,000 to 300,000. The increase in Disability payments has had an important impact on the increase in the most recent projected pay-as-you-go rate.

17.3 Important improvements need to be made to management practices related to the eligibility of Disability benefits. Moreover, CPP management does not have complete and relevant data that would enable it to manage eligibility with due regard to economy. We noted that:

- management information systems are limited and do not allow for sound analysis. Variances between actuarial estimates and actual results have not been examined and reported regularly;
- applications are often adjudicated on the basis of information obtained from the applicants and their physicians. No analysis has been carried out to determine at what stage in the process it would be most economical to search for additional information;
- quality control necessary to improve the soundness of disability adjudication is neither formal nor systematic;
- the effect of guidelines on the number and profile of new applications accepted is not determined;
- few beneficiaries are subject to reassessment for assessing continuing eligibility; and
- there is limited exchange of information between the CPP and other disability plans.

17.4 In the last decade, the CPP has faced an unprecedented increase in the number of disability claims, as have other public and private disability plans. CPP administration undertook a study to identify the reasons for the increase, although no quantification was done. Several measures undertaken to respond to the concerns raised in the study were:

- new incentives to reduce barriers to employment of CPP Disability beneficiaries;
- revised Disability determination guidelines;
- improved communication with clients; and
- improvement of the reassessment program.

Main Points (cont'd)

CPP management is starting to come to grips with determining more clearly the causes of growth in Disability payments. The number of beneficiaries has declined recently, for the first time in several years. Many of the new initiatives show promise for the future. We commend all those involved for their efforts to improve the situation. It is too early, however, for the Office to comment on the success of these endeavours, as the number of appeals has grown steadily at all levels for the same time period.

17.5 Guidelines introduced over the years have had a significant impact on costs, which are reflected eventually in the long-term projected contribution rate. While legislative changes require estimates of the impact of contribution rates, and formal consultation with the provinces, we are concerned that some important changes to Disability eligibility practices were introduced in the past without proper assessment of projected costs or actuarial impact analysis.

17.6 The actual cost of Disability benefits exceeded actuarial estimates for the period reviewed until 1995. The roles and responsibilities of the CPP and the Chief Actuary of the Office of the Superintendent of Financial Institutions for ensuring the reliability and integrity of the data used for actuarial projections are unclear. Furthermore, we believe that the Department would benefit from having in-house actuarial expertise to improve the exchange of operational and strategic information.

17.7 The Canada Pension Plan was created in 1966 as a mandatory social insurance program to provide some measure of protection to Canadian workers and their families from loss of earnings resulting from retirement or death, as well as from serious and prolonged disability. CPP Disability provides, on average, about half of recipients' incomes; this share is partly due to the fact that some other income providers reduce their benefits by the amount of CPP Disability benefits. This makes the Plan a first payer in most situations.

17.8 There is limited exchange of information between the CPP and provincial plans or private insurers on medical assessment, decisions rendered, rehabilitation, follow-up and termination of payment to beneficiaries who are receiving benefits from more than one of these organizations. However, the Act that governs the disclosure of information considerably limits the exchange of information. Because there is little co-ordination, beneficiaries often provide the same information to several plans, which results in unnecessary duplication of effort and cost. Better co-ordination among the plans would not only improve service but also reduce expenditures for all plans.

17.9 Recent evaluation studies provide useful information about beneficiaries and alternative ways of providing public disability insurance. Overall, the issues and questions addressed by the studies were appropriate and extensive. The evaluation's Interim Report presented a number of proposals for improving adjudication and appeals processes. The fact that CPP Disability does not have precisely defined objectives has hampered the evaluation's measurement of program success. More discussion and clarification of what CPP Disability is expected to accomplish would be desirable. In addition, more information is needed to cover the significant performance information gaps. The Department has yet to take sufficient steps to fill the identified gaps.

17.10 Our audit did not attempt to determine whether the CPP is a better plan than the Quebec Pension Plan (QPP) from the viewpoint of either the beneficiaries or the contributors. CPP legislation requires that comparable benefits be provided by the Canada Pension Plan and the QPP. The legislation allows a province to opt out of the CPP provided that the province sets up a comprehensive pension plan that provides benefits comparable with those provided by the CPP. According to CPP management, changes to both the CPP and QPP over the years have resulted in differences that at times have increased the distinctions and at other times narrowed them. It is therefore important to evaluate the differences between these plans and make adjustments where appropriate. Important differences between the Disability programs of the two plans have been identified, which may explain the increasing disparity between utilization rates.

Main Points (cont'd)

17.11 We recognize that determination of disability is a very difficult task. However, every effort should be made to minimize subjectivity in the process. In the context of regionalization, closer monitoring and proper guidance would assist adjudicators in making fair and consistent decisions. Tighter controls on the quality of decisions and greater emphasis on operational controls, such as reassessment, would also reduce the risk of paying benefits to persons no longer eligible. It is important that CPP management have appropriate controls in place to ensure that those, and only those, who are eligible for benefits are accepted and/or continue to receive benefits and that all beneficiaries are treated equitably and in compliance with the legislation.

17.12 We acknowledge that the issues we have raised in this chapter will be difficult to resolve and cannot all be addressed at once. Those involved in administering CPP Disability would benefit from a comprehensive action plan that sets out the accountability, priorities, responsibilities and resources, if required. Such a plan would foster a common mindset on the issues. The number of recommendations proposed implies that additional resources may be required, although the success of many ongoing projects will depend to some extent upon other projects being implemented concurrently. We are convinced, however, that significant savings in program costs can be achieved as a result of additional efforts to improve the administration of CPP Disability and without causing any prejudice to applicants who meet the eligibility criteria of the Plan.

Introduction

17.13 Human Resources Development Canada was created in 1993 to consolidate within a single national body some of the federal government programs and activities related to income security and human resources development.

17.14 The main focus of Income Security Programs is to provide benefits that promote or improve income security for the elderly, persons with disabilities, survivors and migrants. The two major areas of activity are Old Age Security and the Canada Pension Plan.

17.15 The Canada Pension Plan (CPP) is a social insurance program with the objective of ensuring some measure of income protection to Canadian workers and their families against loss of earnings resulting from retirement, serious and prolonged disability or death. The CPP is a federal-provincial plan in force in all the provinces and territories with the exception of Quebec, which has a similar plan, the Quebec Pension Plan (QPP). Any changes to the CPP require the agreement of two thirds of the provinces with two thirds of the population. This is a unique feature of the Plan. CPP Disability is a component of the CPP and is not, as such, administered as a separate program or entity.

17.16 Employers and almost all wage earners and self-employed workers between the ages of 18 and 65 are obliged to contribute to the CPP. Approximately 10 million workers and 1,200,000 employers contribute annually to the Plan. Of the 3,674,000 persons to whom monthly CPP benefits are to be paid in 1996–97, approximately 300,000 will receive Disability benefits and 100,000 children of disabled contributors will be entitled to monthly flat-rate benefits.

17.17 To be eligible for CPP Disability benefits, a person must be between the ages of 18 and 65, have contributed to the Plan for at least two of the last three years or five of the last ten years before the date of the disability, be disabled according to the definitions of the Plan, and apply in writing on a prescribed form. Benefits are payable monthly, after a waiting period of three months, until the person dies, reaches the age of 65, regains capacity to work or is no longer disabled for CPP purposes. In 1996, monthly Disability benefits range from a minimum of \$326 to a maximum of \$871. A person who receives Disability benefits is also entitled to benefits of \$164 per month for each dependant child up to the age of 18, or 25 if the child is attending an educational institution full time. Disability benefits are indexed to the cost of living and are taxable. There is no provision in the CPP for partial payments.

17.18 By virtue of the legislative provisions governing the CPP, departmental personnel administer the benefits, Revenue Canada collects the contributions, the Department of Finance manages the Investment Account and the Chief Actuary of the Office of the Superintendent of Financial Institutions prepares the actuarial estimates.

17.19 The management and delivery of Income Security Programs (ISP), including CPP and Disability, are fully integrated. National headquarters is headed by an assistant deputy minister who is responsible for operational and program policy development, national planning, program integrity and the monitoring of program and policy implementation of all ISP activities. In each province, implementation of all departmental programs and delivery of services are co-ordinated by a regional executive head supported by a Service

**In 1996–97,
approximately 300,000
persons will receive
Disability benefits.**

Delivery Network under his administrative authority. The regional executive heads are responsible to the Deputy Minister. ISP activities are being integrated into the Department's regional Human Resource Centres.

17.20 Some CPP Disability operations are currently being regionalized. Regional offices are now responsible for initial assessment of applications for Disability benefits, the first two levels of appeal (reconsideration and Review Tribunal) and related administrative processing. The timetable for regionalization runs from November 1995 to 1998. Regionalization is an important challenge for headquarters, in that implementation of Income Security Programs requires that they be co-ordinated with other programs administered in the regions. The regions must deal with staff cuts, major restructuring of other programs due to legislative changes and significant changes to administrative and operating systems.

17.21 Over the last three years, Income Security Programs has been restructured, with new incumbents assuming most management positions, as in many other sectors of the Department. In addition to having to deal with the human resource implications of downsizing, Program Review, Service Delivery Network and implementation of the ISP Redesign Project, the management and staff have undertaken several initiatives and/or projects to address ongoing issues. These initiatives are described in the Estimates Part III – Expenditure Plan, which is available to the public and Parliament, and is updated annually. Management has also responded to the Public Accounts Committee's report on outstanding matters resulting from our 1993 audit.

17.22 At a time of budgetary constraint, public and private disability benefit

programs are the subject of in-depth studies in Canada, and indeed in all Western countries. In many countries, disability benefits have reached unprecedented heights in the last decade in terms of payments and caseloads.

Disability is a complex state and difficult to determine with precision

17.23 The status of persons with disabilities remains a complex social issue and is difficult to determine with precision. It entails especially sensitive human, moral and emotional dimensions. It is made up of individual cases all different from one another, from which it is impossible to draw general conclusions. Moreover, the same type and degree of disability may have very different implications, depending on the individual and the circumstances. While it may be impossible to determine with absolute or scientific certainty whether a disability prevents an individual from working, CPP administration is responsible for ensuring that only the individuals who are entitled receive the benefits.

17.24 According to the *Canada Pension Plan Act*, a person is considered to be disabled only if he or she is determined to be suffering from a severe and prolonged mental or physical disability. A disability is severe only "if by reason thereof the person in respect of whom the determination is made is incapable regularly of pursuing any substantially gainful occupation." A disability is prolonged only if it is determined that the disability is "likely to be long continued and of indefinite duration or is likely to result in death."

17.25 A beneficiary who is dissatisfied with a decision can ask the Minister of Human Resources Development, in writing, to reconsider it, within 90 days of receiving the decision. If the beneficiary is still dissatisfied after reconsideration, an

CPP administration is responsible for ensuring that only the individuals who are entitled receive the Disability benefits.

appeal may be lodged with the Review Tribunal. The Tribunal, which is an entirely independent body, can confirm or reverse the decision made at the reconsideration level. Any party to the appeal who is dissatisfied with the Review Tribunal's decision may request leave to appeal to the third level of appeal, the Pension Appeals Board (Board). Unlike the first two levels, an appeal to the Board is not automatic upon request. Decisions of the Board are subject to judicial review by the Federal Court of Canada.

17.26 Disability benefits are not granted according to specific medical diagnoses but rather on the basis of an assessment of the extent to which a medical condition prevents an individual from being able to engage regularly in any substantially gainful occupation. Those familiar with the process consider it impossible to eliminate all subjectivity in adjudicating Disability applications because some eligibility criteria are considered subjective compared with the

criteria that govern other programs in the Plan. For instance, criteria based on age, years of contribution and date of death allow for an objective decision with a minimum of intervention. The consequences of error are costly, both for the Plan and for persons to whom benefits may be unfairly denied.

Disability benefits have more than tripled over the past decade

17.27 From the beginning of the Plan in 1970–71 until now, Disability benefits paid out have amounted to over \$23 billion, representing about 16 percent of total CPP benefits paid for that period.

17.28 Over the past 10 years, Disability benefit payments have more than tripled, climbing from \$841 million in 1986–1987 to close to \$3 billion in 1995–1996. Disability benefits currently account for 17.5 percent of total CPP payments. As Exhibit 17.1 shows, Disability benefit payments climbed sharply in 1987–88 and 1993–94, the years corresponding to the coming into force of major legislative

Year	Total CPP Payments (\$ millions)	CPP Disability Benefits		CPP Administration Costs (\$ millions)	Human Resources ISP ¹ (FTE ²)
		(\$ millions)	%		
1986–1987	5,721	841	14.7	140	2,957
1987–1988	7,329	1,189	16.2	135	2,758
1988–1989	8,445	1,411	16.7	134	2,714
1989–1990	9,473	1,572	16.6	145	2,582
1990–1991	10,542	1,723	16.3	163	2,486
1991–1992	11,793	1,975	16.7	134	2,385
1992–1993	13,199	2,279	17.3	168	2,699
1993–1994	14,402	2,683	18.6	187	2,797
1994–1995	15,257	2,855	18.7	200	2,978
1995–1996	15,969	2,794	17.5	219	3,123 ³
1996–1997 ³	17,218	3,198	18.6	209	2,971

¹ Income Security Programs

² Full-time equivalent

³ Estimates

Source: Human Resources Development Canada,
Estimates, Part III, Expenditures Plan

Exhibit 17.1

Cost of Disability Benefits and Resources of Canada Pension Plan

amendments (see paragraphs 17.40 to 17.46). While benefit payment information is available to the public in the Estimates Part III – Expenditure Plan, information about the cost of administration and other program resources is not.

17.29 The administrative costs of the CPP, including those attributable to Disability benefits, rose from \$140.4 million (or 2.5 percent of total CPP expenditures) in 1986–87 to \$219 million (or 1.4 percent of total CPP expenditures) in 1995–96.

Objective and scope of the audit

17.30 The objective of the audit was to assess the extent to which the causes of the recent growth in Disability benefits are known, the adequacy of management systems and practices for determining initial eligibility for benefits and for monitoring continuing eligibility of beneficiaries, the nature and extent of harmonization and co-ordination with other disability programs, and the quality of the information for measuring and reporting on results to Parliament.

17.31 Our audit did not attempt to determine whether the CPP is a better plan than the QPP from the point of view of either the beneficiaries or the contributors. However, key differences between the CPP and QPP Disability were noted to gain a clearer understanding of the causes of the rapid growth in Disability payments. In addition to the current year, our audit covered past periods in order to better understand the issues and to assess the results of the corrective actions implemented by CPP management. Further details on the objective, scope and criteria of the audit are provided at the end of the chapter, in the section entitled **About the Audit**.

Observations and Recommendations

Causes of Rapid Growth in Disability Benefit Payments

17.32 We believe that a thorough knowledge of the relative significance of the causes of the growth in benefit payments would enable a better understanding of any corrective measures that may be required. As the impact of the changes in benefit rates or in the number of beneficiaries on the growth in benefit payments had not been quantified, we undertook our own analysis with the available data.

17.33 Applications received and accepted reached an unprecedented high of 109,000 and 61,000 respectively in 1993–94. The applications accepted have subsequently dropped to about the same level as terminations. Exhibit 17.2 shows the trends for applications received, applications accepted and terminations for the period 1985–86 to 1995–96. The Department has reported that the number of beneficiaries has declined for five consecutive months since February 1996. CPP management attributes this decline to the implementation of recent administrative measures, such as the adoption of new guidelines to determine medical eligibility. It is too early to conclude on the overall impact of these measures on CPP Disability, as many cases are being appealed.

17.34 The number of beneficiaries rose from 155,000 in 1986–87 to almost 300,000 in 1995–96, an increase of 93 percent (a compound annual rate of growth of 6.8 percent). Over the same period, the labour force (persons 15 and over who had a job or were unemployed) rose by 11.9 percent (compound annual rate of growth of only 1.1 percent). In

Applications received and accepted reached an unprecedented high of 109,000 and 61,000 respectively in 1993–94.

contrast, the number of Quebec Pension Plan beneficiaries remained relatively stable over the same period. The differences between the two plans are analyzed in paragraphs 17.134 to 17.142.

17.35 The increase in Disability payments, particularly since the mid-1980s, has had an important impact on the increase in the most recent pay-as-you-go (PAYGO) rate (ratio of the year's projected total expenditures to the year's projected total contributory earnings) projected by the Chief Actuary of the Office of the Superintendent of Financial Institutions. Our review of the changes in the PAYGO rates projected in 1985 and 1993 for the year 2025 revealed that the main cause of the increase is the Disability component of the CPP. Exhibit 17.3 outlines the causes of the main changes in those PAYGO rates. Disability accounts for 61 percent of the increase in the projected rate.

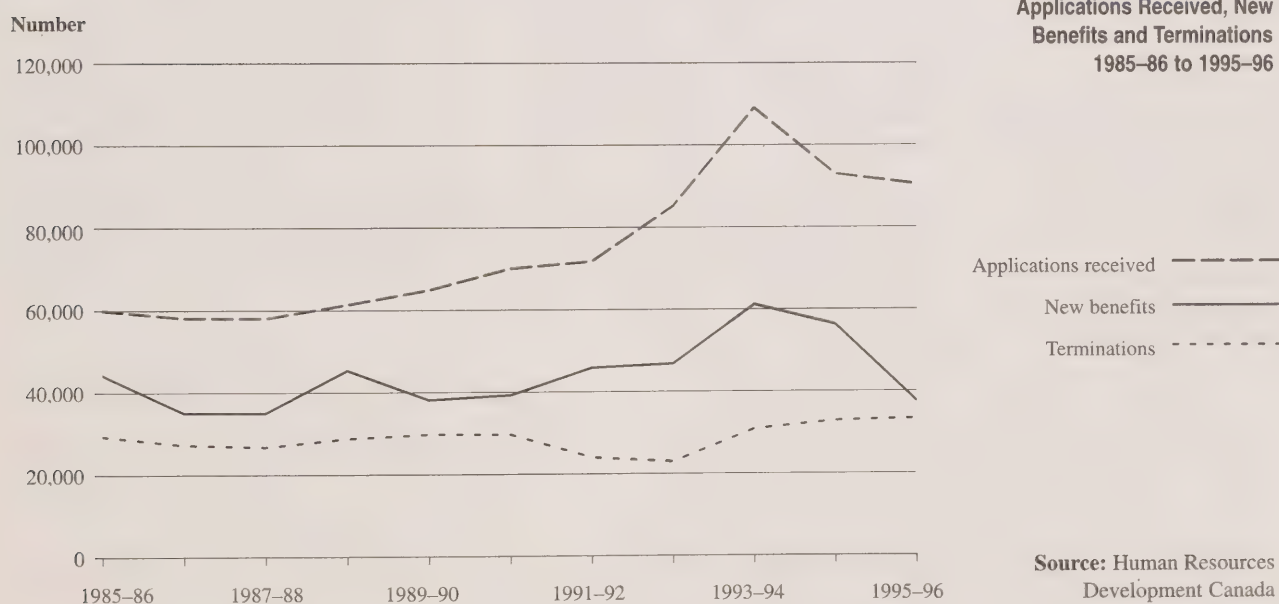
Delayed reaction to cost increase

17.36 Although benefit payments and the number of beneficiaries have increased steadily over the years, especially since 1986, only recently did the Department undertake an in-depth study of the underlying causes of the increase in payments.

17.37 Repeated questions from the Chief Actuary, especially since December of 1993, on the causes of a 30 percent increase in the incidence rate (number of new beneficiaries divided by working population) spurred the Department to undertake the Study on the Incidence of Disability. The results of this study were made public in 1995.

17.38 The Department's study outlined a number of factors that potentially contributed to the rapid increase in the number of beneficiaries and in benefit payments. Among the most important factors were:

The increase in Disability payments has had an important impact on the increase in the most recent pay-as-you-go rate.



Increases in the number of beneficiaries account for the largest proportion of the cost increases.

- legislative amendments increasing the statutory benefit rates and reducing the number of years of contribution required for eligibility (1987) and authorizing retroactive applications (1992);
- guidelines issued in 1988–89 to explicitly consider age and socio-economic factors, such as opportunities for employment, in assessing the eligibility of applications;
- increases in the number of applications due to unfavourable economic conditions in the early '90s (recession and high unemployment);
- increased efforts on the part of other programs to refer their applicants to CPP Disability (for example, provincial social assistance programs, private insurers that cover long-term disability and workers compensation plans); and
- increased efforts to improve public awareness of the Plan.

17.39 However, the Department's study did not quantify the impact of any of these factors on the growth in the number of beneficiaries. Thus their relative importance in causing the increases is not known. In particular, the study did not assess the relative impact of benefit rate and caseload increases on the growth in Disability payments. While the limited data restricted considerably our ability to quantify the causes, enough data were

available to understand the relative impact of legislative rate changes versus increases in caseloads.

Cost increase due in part to legislative changes

17.40 We undertook to examine the significance of the changes in benefit rates and in the number of beneficiaries on the growth in Disability benefit payments for the period 1986–87 to 1994–95 — the period of the most significant recent rise in costs (see Exhibit 17.4). We found that changes in benefit rates accounted for 34 percent of the total increase in benefits paid for the period examined. In other words, if the number of beneficiaries had remained constant, total Disability benefit payments would still have climbed by 34 percent, because of the increase in statutory benefit rates. Legislative changes introduced in 1987 are the principal source of this increase in benefit rates for contributors and their eligible children.

17.41 Our analysis also indicates that the increases in the number of beneficiaries account for the largest proportion of the cost increases. Even if benefit rates had not risen, these additional beneficiaries would have caused costs to increase by 36 percent. In addition, they received the new rates, which explains the remaining 30 percent of the cost increase. The increase in the

Exhibit 17.3

Canada Pension Plan
Projected Pay-as-you-go
Rates for the Year 2025

Pay-as-you-go Rate (Costs as a Percentage of Contributory Earnings)		
Rate in 2025 as projected in 1985		11.26
Changes in projected rates:		
• retirement	1.05 (47%)	
• disability (including children)	1.36 (61%)	
• survivor, orphans and death	(0.17) (–8%)	2.24
Rate in 2025 as projected in 1993		13.50

Source: Actuarial reports of the Chief Actuary, 1985 and 1993

number of beneficiaries comes from changes in the following rates: application rate (number of applications divided by working population), approval rate (number of applications accepted divided by number of applications) and termination rate (number of terminations divided by total number of beneficiaries). To assess the relative significance of these changes, we computed the averages of these rates and of the labour force for three five-year periods from 1980–81 to 1994–95. Exhibit 17.5 illustrates these trends.

17.42 Over the period 1980–81 to 1994–95, the labour force grew by 17.9 percent. Some of this growth, up to about 1986, was due to “baby boomers” coming into the labour force. Since 1986, growth in the labour force has been mainly due to population increase and increased participation by women. Since the incidence of disability is strongly correlated with age, we would have expected application rates to go down during the earlier part of our analysis period and to begin rising only as “baby boomers” hit their late forties. The oldest boomers, those born in 1946, turned 45 in

1991. For these reasons, labour force growth is not considered to be a major factor in the application growth over this period.

17.43 In our opinion, one of the main reasons for the increase in the number of beneficiaries is the increase in the application rate (by 73 percent). It is not possible with the data available to determine why this should be the case. However, background studies done for the recent evaluation of CPP Disability also support the importance of the application rate. They conclude that the unfavourable economic conditions in the early 1990s (for example, high unemployment rate) combined with the 1987 and 1992 legislative changes have had a significant impact on the variation in the observed application rates.

17.44 Fewer (by 19 percent) beneficiaries were accepted in relation to the applications received. Greater visibility of the disability program among applicants may have contributed to increasing the number of applications that were less credible and thus more likely to be denied. In addition, the approval rate

The increase in the number of beneficiaries is due mostly to the increase in the application rate.

Benefits paid in 1994–95		2,855	
Benefits paid in 1986–87		841	
Total increase		2,014	(100%)
Additional costs due to increase in:			
– statutory flat rate	● adult	353	
	● child	64	
– inflation in rates and taxable earnings		167	
– retroactive payments		108	692 (34%)
Additional costs due to increase in average number of beneficiaries using 1994–95 average benefit rate:			
– adults (from 155,077 to 287,664, or 132,587)		1,195	
– children (from 52,155 to 100,900, or 48,745)		127	1,322 (66%)

Exhibit 17.4

Breakdown of Increase in Cost of Disability Benefits between 1986–1987 and 1994–1995

(\$ millions)

for applications stemming from the 1992 amendment to the *Canada Pension Plan Act* (thereby accepting retroactive applications) is approximately half the acceptance rate for other applications. The Department estimates that it received about 52,850 retroactive applications, 15,670 of which were accepted between January 1992 and 31 March 1995.

17.45 The drop (by 35 percent) in the average termination rate can be explained in part by the average age of new beneficiaries; they are younger and therefore receive Disability benefits for a longer period. This drop would also have had a significant effect on the increase in caseload.

17.46 For purposes of evaluation, strategic decision making, redirection and accountability, we encourage the Department to give continuing attention to determining the fundamental causes underlying the changes in the cost of Disability benefits.

Lack of relevant data restricts analysis of causes of cost increase

17.47 The Department has not developed a plan outlining the nature, frequency and scope of the data to be

collected for assessing the causes of cost changes. Although the Department publishes various statistics relating to beneficiaries, benefit rates and expenditures, we found that the data collected are insufficient to enable in-depth analysis or quantification of causes. In the 1995 Study on the Incidence of Disability, the Department recognizes “data limitations to be the most serious obstacle to understanding what has been going on and to managing Disability processes accountably in the future.” Furthermore, the recent evaluation was unable to reach conclusions on major issues because of the lack of data.

17.48 In particular, the Department until recently has had no data on the population covered, that is, the number of contributors who contributed during two of the last three years or five of the last ten years. Moreover, the profiles of applications received and applications accepted and denied as a result of significant legislative or administrative amendments are not known. Efforts are currently being made to develop profiles. Such information is crucial for a better understanding of the changes in the cost of Disability benefits.

Exhibit 17.5

Trends in Labour Force and Key Rates from 1980–81 to 1994–95

Factors	1980–81 to 1984–85 (average)	1985–86 to 1989–90 (average)	1990–91 to 1994–95 (average)	Variation 1980–81 to 1994–95
Labour force (thousands)	9,354	10,305	11,026	+17.87%
Application rate (per 1,000 working population)	4.50	5.90	7.80	+73.33%
Acceptance rate	71.73%	65.46%	58.32%	–18.70%
Termination rate	20.07%	16.13%	13.03%	–35.08%

17.49 Once the essential data are gathered, early-warning indicators could be used to closely monitor unusual or unexpected changes in the profiles of applications, approvals and terminations and to take appropriate measures where required. Such indicators are fundamental, given that the Department is decentralizing its operations. The Department informed us that they are being developed and will be implemented soon.

17.50 The Department should:

- **establish, as soon as possible, a comprehensive plan for gathering data and analyzing changes in the Disability benefits paid; and**
- **implement early-warning indicators to identify, in a timely fashion, any unusual changes in the profile of potential or existing Disability beneficiaries that require closer monitoring.**

Department's response: The Department agrees that a comprehensive plan for data gathering is necessary. Indeed, at the time of the audit, the Department was in the midst of establishing a new trend analysis system. Income Security Programs is currently collecting data and monitoring trends on CPP Disability and is building the capacity to collect other management data. Ongoing analysis of the changes in the incidence of CPP Disability benefits is producing regular reports on the variances between the actual/projected caseloads and the analysis of these variances. While it is not the CPP's administrative responsibility to conduct profiling of potential disability beneficiaries within the entire social security system, the administration keeps itself abreast of the information in this area, by using such tools as HALS (Health And Limitations Surveys by Statistics Canada) for forecasting of potential future disability beneficiaries.

Memorandum of understanding unclear as to roles and responsibilities

17.51 The current memorandum of understanding between the Chief Actuary of the Office of Superintendent of Financial Institutions and the Department does not specify their respective roles and responsibilities regarding the reliability and integrity of the data used by the Chief Actuary. For example, the Chief Actuary uses data supplied by the Department in establishing the actuarial estimates. With respect to approved retroactive applications, we found that the date of disability entered in the Department's computer system is 15 months prior to the application date, which does not necessarily match the actual disability date. In cases where the application is received several years after the disability occurred, the exact date of the onset of disability is often very difficult to determine and administer. The impact of this discrepancy on the incidence rate calculated by the Chief Actuary has not been determined.

17.52 In order to have an independent opinion, the Canada Pension Plan stipulates that three-year and five-year actuarial estimates, and estimates relating to legislative changes, must be made by the Chief Actuary.

17.53 We examined the assumptions made for financial forecasts by the Chief Actuary in his Fifteenth Actuarial Report as at 31 December 1993 and found them to be adequate and appropriate. The Chief Actuary pointed out, "Higher projected expenditures in the long term, as compared to the previous report, stem primarily from the assumption that the higher incidence of disability (number of new cases as a proportion of the eligible population) experienced in recent years will be a permanent feature of the CPP."

The profiles of applications received and applications accepted and denied as a result of legislative amendments are not known.

The causes of the variances between actuarial estimates and actual results have not been analyzed and reported.

17.54 The impact of the 1987 and 1992 legislative changes on estimated future disbursements for CPP Disability benefits is forecast and disclosed by the Chief Actuary in a separate actuarial report, as required under the Plan. For example, the additional annual disbursements stemming from the coming into force of Bill C-57 in June 1992, which allowed the acceptance of retroactive claims, were estimated to be \$30 million in 1992, and to increase gradually to \$57 million by the year 2000. Exhibit 17.6 shows that the actual costs of CPP Disability benefits have always exceeded the actuarial estimates, except for 1995.

17.55 As the actual additional disbursements resulting from the legislative changes have not been computed by the Department, the causes of the variances between actuarial estimates and actual results have not been analyzed and reported. The memorandum of understanding does not cover such a requirement. As a result, important lessons to be learned could not be drawn from such unexpected variances, and corrective measures that need to be taken were not

determined. We noted that a QPP actuarial report outlines the causes of the variances between actuarial estimates and actual results.

17.56 Analysis of variances between actuarial estimates and actual disbursements would enable officials to understand the causes underlying unexpected changes, to take corrective measures in a timely fashion and to use the lessons learned to improve forecasting practices.

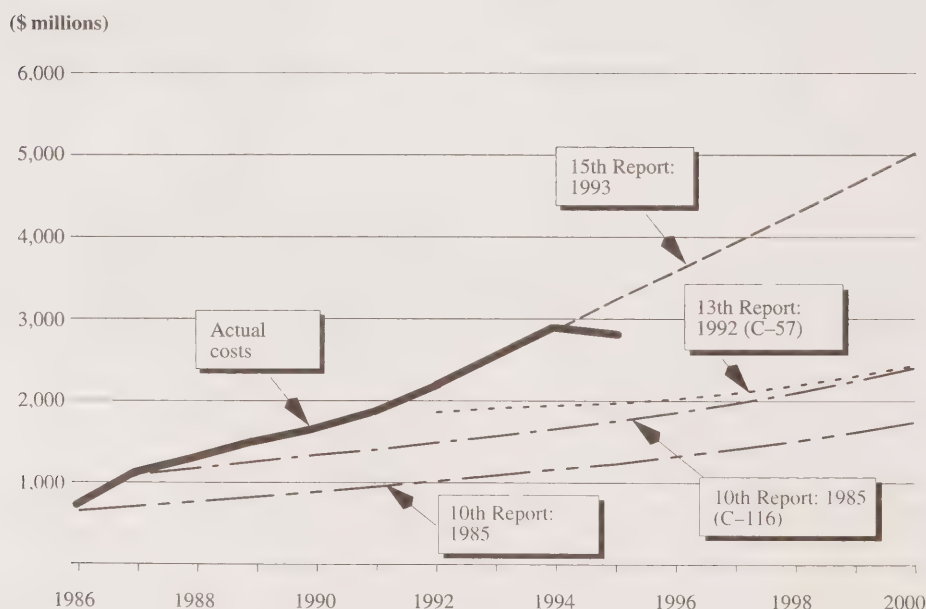
17.57 If the Department had in-house actuarial expertise, the collection, analysis and exchange of operational and strategic information between the Department and the Chief Actuary for management and forecasting purposes would be far easier.

17.58 This type of expertise, however, does not reside in the CPP. The administration informed us that in the past it has used services of the Chief Actuary that are not specified in the legislation. Taking into account the responsibilities of the Chief Actuary, which are not limited to the Plan, the CPP could benefit from having in-house actuarial expertise.

Exhibit 17.6

**Actuarial Estimates Compared
with Actual Costs**

Disability Benefits



Source : Actuarial Reports of
the Chief Actuary

17.59 The Department should:

- clarify with the Chief Actuary, in the existing memorandum of understanding, their respective roles and responsibilities regarding reliability and integrity of data used by the Chief Actuary for actuarial forecast of CPP Disability benefits;
- analyze the reasons for the variances between actual results and financial forecasts of CPP Disability benefits prepared by the Chief Actuary and disclose them to the federal and provincial authorities; and
- define its essential needs in terms of actuarial and/or analytical expertise for the CPP Disability program and analyze the most cost-effective way of acquiring such expertise, where applicable.

Department's response: The Department has the ultimate responsibility for the reliability and integrity of program data used by the Chief Actuary. The Department will confirm the roles and responsibilities in this area with the Chief Actuary, by revising the existing memorandum of understanding, as deemed necessary. The CPP has already committed to report annually in detail to the provinces on the administration of the CPP Disability program. This will be done in conjunction with the CPP Annual Report, which will include the reporting on any discrepancies between the actuarial estimates and the actual program expenditures. The Department will also proceed to define its needs and capabilities in terms of actuarial/analytical expertise and determine the most effective method of acquiring such expertise.

Management Practices for Assessing Eligibility

17.60 We examined management practices for assessing applicant eligibility. Our examination covered the

implementation of the provisions of the *Canada Pension Plan Act* and the regulations with respect to the adjudication of an application, including appeals, continuing eligibility for benefits and exchange of information with other programs for persons with disabilities.

Key guidelines affecting adjudication of applications are not entrenched in the Act

17.61 When the criteria to be considered in adjudicating an application are changed, CPP administration can either issue guidelines or recommend legislative changes. During the 1980s and 1990s, the administration did both.

17.62 According to the Act, the following types of substantive amendments require provincial consent to come into force:

- general level of benefits;
- classes of benefits provided;
- contribution rate;
- formulas for calculating the contributions and benefits payable;
- management or operation of the CPP Account or the CPP Investment Fund; and
- constitution of, or duties of, the CPP Advisory Board.

17.63 Each time a bill is introduced in or presented to the House of Commons, the Chief Actuary shall, under the Act, prepare a report on the extent to which the bill, if enacted by Parliament, would materially affect any of the estimates contained in the most recent actuarial report. Furthermore, consultation with the provincial governments is mandatory since a legislative change requires approval of two thirds of the provinces (including the Province of Quebec) with two thirds of the population. Several legislative changes affecting disability

Consultation with the provincial governments is mandatory since a legislative change requires approval of two thirds of the provinces with two thirds of the population.

have been introduced since the inception of the Plan.

17.64 During the 1980s, CPP management issued guidelines affecting application adjudication. Exhibit 17.7 sets out two guidelines that documented practices already in force related to adjudicating an application. The guidelines also reflected judicial decisions by the Review Tribunals and the Pension Appeals Board, which could explain why management did not consider that legislative changes were needed at that time. Although the guidelines represented an important change, their impact on the number of applications accepted and the contribution rate has not been assessed. Management did identify them as a factor in the increase in costs (see paragraph 17.38).

17.65 With the implementation of the March 1989 guideline, an interpretation of “prolonged” was provided (see Exhibit 17.7). Because the interpretation allows for a regained capacity to work within one year, with an element of uncertainty as to when, it requires regular monitoring. Indeed, some beneficiaries do eventually re-enter the job market; however, the reassessment process needs

to be improved (see paragraphs 17.88 to 17.99).

17.66 The guidelines were revised in September 1995. Henceforth, socio-economic factors are no longer considered in adjudicating an application and no special consideration is given to persons aged 55 and over. According to CPP administration, all applicants are now treated consistently.

17.67 At the request of CPP administration, the Chief Actuary assessed the impact of revising these guidelines on the incidence rate of disability. He concluded that the changes to the guidelines constituted a change in the Plan provisions. He pointed out that this type of amendment should normally be considered in terms of effect on the cost of funding and benefits at the time of the five-year review of contribution rates by the ministers of Finance.

17.68 According to CPP administration, changes in projected program costs, including those derived from the interpretation of the guidelines, are examined jointly by federal and provincial governments within the quinquennial review process. Because the impact of the 1988–89 guidelines has never been

Exhibit 17.7

**Guidelines Affecting the
Adjudication of Applications**

October 1988	For persons 55 years of age or over, the disability is considered severe if it prevents the applicant from doing his own occupation rather than any substantially gainful occupation. This guideline was revoked in September 1995.
March 1989	<ul style="list-style-type: none"> Reasonable access to suitable employment given the applicant's limitations, the regional unemployment rate, and the predominant language spoken in the region are considered in adjudicating an application (so-called socio-economic factors). This part of the guideline was revoked in September 1995. For a disability to be prolonged, it will continue for a significant time <u>and</u> the duration of the disability cannot be predicted with certainty <u>or</u> the disability is likely to result in death. If the capacity to work will not be regained within one year or there is a possibility of regained capacity within one year but an element of uncertainty exists as to when, it can be concluded that the disability is both “long continued and of indefinite duration”.

Source: Human Resources
Development Canada

assessed and made public, there is no evidence that they were ever the subject of a review by the federal and provincial governments.

17.69 What impact did the guidelines have on the projected contribution rates? Should the guidelines have been entrenched in the Act? Should the provinces have been formally consulted? Where do the responsibilities of CPP administration for interpreting the Act begin and end? These questions need to be answered.

17.70 The Department should assess the effect on the cost of funding and level of benefits of any proposed amendments in the adjudication of applications, in order to determine whether the amendments should be reflected in a guideline or in the Act.

Department's response: The quinquennial review of the CPP examines, among other issues, the projected changes in program costs, including costs associated with the interpretation of the guidelines. The Department does not assess the substance of any suggested amendments to adjudication rules in isolation; both federal and provincial governments are consulted in the process.

It must be understood that in the absence of written guidelines, the responsibility of officials to apply the law in adjudication would have to be fulfilled, as it was prior to 1989, without a source of uniformity and accountability. However, it would remain the case that those adjudications would and should be affected by judicial interpretation and legal advice. The absence of guidelines would not in any way ensure a static interpretation of the law over time.

Parliament has the responsibility to make changes to the CPP. Section 114.4 of the CPP specifies which type of amendments would also require provincial consent to

come into force. The administration is very careful to ensure that these rules are applied to fully respect the role of the provinces. For example, extensive consultations took place with provinces and provincial approval was sought before Bill C-57 became law.

Information essential to manage is deficient

17.71 CPP management lacks complete and relevant information that would enable it to manage eligibility for benefits with due regard to economy. Exhibit 17.8 summarizes our observations on information that is available, incomplete or not available, or simply not generated.

17.72 The management information systems are limited, that is, they do not capture all the data necessary for sound analysis. Even with limited systems, CPP management should have been able to produce some data on performance measurement; it has not done so. Information gaps make it impossible for management to fulfil its responsibilities completely. It is essential, especially in the context of regionalization, that the management information system be improved to provide the necessary data to support well-informed decisions.

17.73 The proposed computer system currently being developed under the ISP Redesign Project is expected to be fully operational by the year 2000. This system could in part meet CPP management's information needs. In the meantime, however, management still needs essential information to ensure sound management of resources and operations.

17.74 The Department should take steps, even if they are only interim, to fill the identified gaps in management information on the eligibility for CPP Disability benefits.

Department's response: The Department has taken a number of steps to improve its

It is essential, especially in the context of regionalization, that the management information system be improved to provide the necessary data to support well-informed decisions.

management information. It has recently introduced the Disability Caseload Growth Analysis report, aimed at senior management, which provides monthly information on trends relating to disability caseload growth such as applications, new grants and denials, appeals and terminations. The report also tracks disability expenditures.

Income Security Programs produces regular operational administrative statistics covering caseload, new benefits and expenditures according to various demographic categories of beneficiaries. These data are critical to the development and analysis of trends within the program.

Income Security Programs has recently improved its capacity to analyze trends in disability and demographic profiles within the client population. This has allowed the Department to better determine the impacts of proposed policy changes to the program.

Lack of consistency in adjudicating applications

17.75 Determination of disability as defined by the Act is frequently difficult and usually complex. According to the Act, a person is disabled and entitled to benefits only if he or she is suffering from a severe and prolonged mental or physical disability, where severe means “an impairment preventing pursuit of any substantially gainful employment”, and prolonged means “long continued and of indefinite duration, or likely to result in death” (see paragraphs 17.23 to 17.26).

17.76 In practice, however, each case is unique and determination of eligibility cannot be entirely objective. Some individuals respond better to treatment; a secondary condition may have an impact on the primary condition; some individuals have a stronger desire to continue working. This is why, especially

Exhibit 17.8

Availability of Information Necessary to Manage Eligibility

Information available

- Quantitative reports responding to specific needs (e.g. data on workload) and prepared on a regular basis
- Progress reports on a plan of action to reduce 1993 backlogs

Information incomplete or unavailable

- Some reports on volumetric data (e.g. data on beneficiary profile, medical reports) do not include all information useful for decision making
- Error rates in decisions at different levels
- Analysis of reasons for reversal on appeal
- Performance indicators, including targets to be reached and indicators of productivity, processing time and quality of decision

Information not generated

- Cost/benefit analysis of incurring administrative costs for controlling the cost of benefits
- Aggregated rates of applications accepted and applications refused (including appeal figures), for applications received in a given year, are not captured
- Complete cost of processing an application from initial application through the various levels of appeal
- Number of cases referred to specialists at various levels of decision with resultant savings in benefits

in a context of regionalization, tighter monitoring and detailed guidelines are essential to help adjudicators make fair and consistent decisions.

17.77 In fact, some applications denied at the initial evaluation and at the first level of appeal were accepted prior to a hearing at the Review Tribunal. Using the same tools (Act, regulations and guidelines), and based on the same documentation, several adjudicators had arrived at different decisions. More precise and prescriptive guidelines to assess an application could improve consistency.

17.78 Assessment of an applicant's capacity to work is not always well documented in the files. In many cases, the physician chosen by the claimant gives an opinion on the applicant's disability and capacity to work, even though the latter is not necessarily within the physician's field of expertise. This information is reflected in a medical report, which can either be sent to the CPP directly by the physician or given to the applicant, who encloses it with the CPP application. The CPP pays up to \$50 directly to physicians for a medical report that supports an application. In most cases, the medical report is given to the applicant. This procedure raises questions concerning the objectivity of the information. The applicant can choose to obtain another report from another

physician if he or she feels the report does not support the application.

17.79 Furthermore, in some instances, information provided by the applicant that indicates a capacity to work is not taken into account (for example, the receipt of regular employment insurance benefits). As illustrated in Exhibit 17.9, incomplete assessment can lead to wrong decisions.

17.80 Adjudicators need guidance on the type and quality of information that is needed to support an application. A search for information is often needed when assessing an application in order to minimize subjectivity in the decision-making process. Applications are often adjudicated on the basis of information obtained from the applicant and his or her physician. This information, however, does not always allow for a well-informed decision because of the issue of objectivity versus subjectivity. Although the adjudicator does not meet the applicant, an attempt to obtain additional information may be made, if deemed necessary. Additional information could come from various other sources, which would add supporting evidence to the application. For example, adjudicators could obtain independent medical reports from specialists selected by the CPP, but they rarely do so. Exhibit 17.10 illustrates a situation where a search for additional information was deemed necessary but was not done.

In most cases, the medical report is given to the applicant. This procedure raises questions concerning the objectivity of the information.

On an application submitted in February 1992, the applicant reported having received regular unemployment insurance benefits until November 1991.

The application was accepted by the adjudicator, who established the date of disability as November 1990. Disability benefit payments started in March 1991. For nine months (March to November 1991), the applicant received regular unemployment insurance benefits and disability benefits. According to the criteria of both programs, a person cannot be entitled to two benefits for the same time period. Indeed, one program requires being available for work and actively searching for a job while the other requires that a person be incapable regularly of pursuing any substantially gainful occupation.

Exhibit 17.9

Disability and Unemployment Insurance

This exhibit supports the observation in the text but is not representative of all cases.

17.81 With regard to retroactive applications, it is difficult to demonstrate that a person was disabled on the cut-off date for qualification. A guideline has been drafted to clarify the information that is necessary to establish the date of disability in such cases. In general, for this type of application, a retroactive payment covering a maximum of 11 months of benefits is paid to the applicant. Exhibit 17.11 illustrates the situation.

17.82 No analysis has been carried out to determine under what circumstances and at what stage in the adjudication process it would be most economical to search for additional information, for example, obtaining a specialist's report or arranging for examination by a physician selected by the Department. How does the adjudicator handle contradictory information obtained from various sources? Could appeals be avoided by obtaining additional information earlier in the process? Analysis of decisions overturned on appeal could identify adjudication training requirements and possible amendments to the Act, regulations and guidelines. Furthermore, this type of analysis would ensure efficient and effective processing of applications.

17.83 Although the Department has attempted to more clearly define eligibility criteria by issuing new

guidelines, files do not always contain information that is both complete and relevant to the decision-making process.

Formal and systematic quality control is required

17.84 Quality control is necessary to improve the soundness of disability adjudication, to determine the causes of errors and to help ensure that all those, and only those, who are eligible have access to benefits. CPP Disability administration does not conduct a formal and systematic quality control review of decisions made by adjudicators. Such a review would enable a determination of whether the Act, regulations and guidelines are respected and whether decisions are justified and made on the basis of reliable, complete information. It would also assure the administration that applications are handled equitably and consistently — whatever the location — a particularly important consideration in the context of regionalization.

17.85 Although the CPP does not have a quality control program, some mechanisms are in place to monitor the quality of decisions, such as:

- random reviews undertaken by the Program Results and Integrity Unit that provide management information on accuracy of payments;

Exhibit 17.10

Search for Additional Information

This exhibit supports the observation in the text but is not representative of all cases.

The administration cancelled the appointment of an applicant with a specialist because the anticipated costs appeared too high (travel costs \$1,000, professional fees \$300 to \$2,000). The appointment had been recommended by the adjudicator.

As a result, the decision to grant a Disability benefit was made solely on the basis of the information on file, despite the fact that the adjudicator had determined an independent assessment to be necessary. To date, the applicant has received \$24,296 in Disability benefits and \$4,681 in benefits for a dependant child.

CPP administration did not assess the cost/benefit of incurring additional costs for an independent medical opinion, which would have supported the applicant's application or confirmed his ineligibility. In the latter case, no benefits would have been paid.

- review of some regional files to monitor the quality of regional decision making;
- peer review of random files; and
- case review committee to discuss difficult cases.

These initiatives do not constitute a quality control program, but they do represent steps to review the quality of decision making. A proposal for continuous monitoring and improvement in CPP Disability is under way and we encourage CPP administration to implement it.

17.86 Quality control, if independent of the unit in which a decision is made, would allow systematic review of important decisions. The administration could select a random sample of cases, analyze the causes of error, take corrective measures, test new adjudication methods and determine adjudicators' training needs.

17.87 The Department should:

- clearly define its guidelines on eligibility for CPP Disability benefits and develop management practices to ensure greater consistency in the adjudication of an application; and
- introduce a quality control program to ensure that the decisions made are relevant and fair.

Department's response: The Department believes that its guidelines on eligibility for CPP Disability benefits are clearly defined and represent the interpretation of the current legislation.

The Department agrees that there is no formal quality review/control program. However, there are numerous quality control mechanisms embedded in the administrative practices of the Department to ensure that the decision-making process for Disability benefits is of high quality, consistent and fair to all clients.

The Department lacks systems that would aid in this endeavour. When the

Context

Bill C-57 allows applicants who failed to submit an application within 15 months to receive Disability benefits if they met the eligibility criteria on the date of disability. The maximum retroactive period for payment of benefits is 11 months preceding the date of application.

Case 1

The applicant left the labour force in 1988. On the basis of the established criteria, the benefit eligibility period ended in 1991. In other words, to be entitled to benefits, the applicant had to prove he was disabled in 1991.

The applicant applied for Disability benefits in 1993 and 1994. These applications were refused by CPP administration, who concluded that the applicant had had the capacity to hold a job in 1991.

In 1995, the applicant reapplied for benefits, which were granted. However, the medical report, dated 1995 and obtained from the attending physician, contained no evidence that the applicant had been suffering from a severe and prolonged disability in 1991.

The administration acknowledges that it granted an application for benefits without obtaining objective evidence that the applicant was disabled on the cut-off eligibility date.

Case 2

An application for Disability benefits was accepted in 1993.

The applicant declared that he had been disabled and incapable of working since 1973 without ever being able to provide evidence to that effect. Benefits were granted where the disability date was based solely on the applicant's statement.

CPP administration granted Disability benefits with no objective evidence of disability.

Exhibit 17.11

Retroactive Application

This exhibit supports the observation in the text but is not representative of all cases.

re-engineering of the current systems under the ISP Redesign Project is complete, the new system will greatly enhance the Department's ability to monitor the quality of decision making. In the meantime, the Department is making the best use of the existing systems. The focus on building front-end quality control mechanisms, as the system is being re-engineered, will continue in line with the Total Quality Management practices and approaches.

A program to monitor consistency in the application of Disability guidelines has been initiated and will be expanded. Further, the existing quality control mechanisms and those being developed will be formalized and set in a strategic framework for quality control of the Disability program.

Reassessment process needs to be improved

17.88 In the context in which the concept of severe and prolonged disability is defined in a broader sense, reassessment needs to be an integral part of the control process. Tighter control on the quality of decisions and greater emphasis on operational controls, such as reassessment,

would reduce the risk of paying benefits to persons no longer eligible.

17.89 Reassessment consists of monitoring and reviewing those files of beneficiaries who may no longer meet eligibility criteria. Monitoring is exercised on a file flagged for reassessment when the application is accepted. When the assessor deems there to be a strong probability that the beneficiary may eventually regain the capacity to work, the appropriate time for reassessment is entered in the file. Control and detection are done by other methods (for example, checking Revenue Canada's record of earnings, complaint from a third party, identification of specific characteristics, a link with another program or other sources of information). Verification of information received from the beneficiary may also be used in reassessment. "Return to work" notices are submitted voluntarily by the beneficiary and indicate to the Minister that a return to work has occurred. Exhibit 17.12 shows the results of reassessment.

17.90 Over the years, the number of Disability beneficiaries has risen

Exhibit 17.12

**Reassessment Results
May 1993 to April 1996**

Reassessment Activities			
Type of Reassessment	Reassessment Decisions	Number of Ceased Payments	Termination Rate (%)
Return to Work	6,996	4,982	71
Record of Earning	2,405	238	10
Other Referrals	1,860	315	17
Prescheduled Reassessment	1,575	106	7
Third Party Complaint	889	122	14
Other Program Matching	818	30	4
Attributes	142	9	6
Total	14,685	5,802	40

Source: Human Resources Development Canada

considerably, to such an extent that, in the mid-1980s, it was necessary to cut back on reassessments as most resources were assigned to processing applications. During that period, only urgent cases were reassessed. In our 1993 Report, we concluded that the Department's reassessment activities were inadequate. Since our 1993 Report, the Department has taken steps to improve its reassessment program by dedicating additional resources, developing a new computer system, undertaking staff training, implementing an integrated communications strategy and expanding reassessment resources for future years. Although a reassessment unit was established, the results obtained indicate that the number of benefit terminations was no greater than in preceding years. Exhibit 17.13 illustrates the benefit termination trend for the past 20 years due to recovery of the capacity to work.

17.91 Beneficiaries who have a reasonable chance to improve medically are identified for subsequent reassessment at the time the application is accepted. However, most of these cases are never reviewed. Over the past three years, the staff have reviewed 1,575 beneficiary files previously flagged. While the Department cannot determine the exact number of files originally flagged, it estimates that thousands of prescheduled reassessments have not been processed on time due to the fact that system problems have prevented CPP administration from identifying those cases. The Department does not give high priority to this type of reassessment, concentrating its efforts instead on handling "return to work" cases. Thus, it appears that important information gathered from the initial adjudicators is almost lost in the process. Exhibit 17.14 illustrates a case where the information obtained at the time the

**Thousands of
prescheduled
reassessments have
not been processed on
time.**

Year	Number of Beneficiaries	Terminations Due to Recovery	
		Number	Percentage
1976	55,488	1,219	2.2
1977	64,838	1,734	2.7
1978	70,469	4,220	6.0
1979	76,857	1,582	2.1
1980	82,991	1,338	1.6
1981	90,522	1,496	1.7
1982	98,824	1,390	1.4
1983	110,877	2,362	2.1
1984	122,481	2,465	2.0
1985	132,883	2,540	1.9
1986	152,961	2,625	1.7
1987	161,222	2,167	1.3
1988	172,145	2,085	1.2
1989	189,369	2,508	1.3
1990	199,565	2,046	1.0
1991	212,423	1,794	0.8
1992	229,322	1,883	0.8
1993	250,700	2,014	0.8
1994	281,190	1,673	0.6
1995	298,698	2,072	0.7

Exhibit 17.13

**Trend in Benefit Termination Due
to Claimants' Recovery of the
Capacity to Work
1976 to 1995**

Source: Human Resources
Development Canada

application for benefits was accepted was not properly used.

17.92 Some control and detection methods to identify ineligible beneficiaries are still being tested. It is difficult to draw conclusions from the results obtained to date on the real potential for future savings. Very few reassessments of this type have been done. If we exclude the “return to work” notices and prescheduled reassessments, only 6,114 reassessments were done over a three-year period.

17.93 Checking the income reported in the beneficiaries’ record of earnings is the method most commonly used by CPP administration in its control and detection reassessments. Based on examination of files for this type of reassessment, we found that better follow-up (average processing time at present is 15 months once earnings have been identified) combined with improved flagging of files would reduce the workload and increase the success rate. Exhibit 17.15 illustrates an example of delays experienced.

17.94 Since 1993, reassessment has focussed on “return to work” notices and

development of a computerized system designed to improve the capacity for analyzing client characteristics. The project has enabled the Department to acquire new tools for improving its reassessment methods and increasing its knowledge. Although the system appears promising, it will be useful only to the extent that it is able to identify high-risk cases.

17.95 Close to half of the reassessments done over the past three years refer to “return to work” notices. Because beneficiaries voluntarily submitted the information, the savings resulting from these cases are unrelated to any monitoring, detection or control efforts by the Department. The total potential savings, as of March 1996, were estimated at \$52 million, of which \$45 million is attributable to cases involving “return to work”.

17.96 New measures to reduce disincentives to work, introduced by the Department in 1995, modify the continuous eligibility criteria. We believe that this policy directive reflects some of the realities faced by disabled persons trying to re-enter the labour market. One

Exhibit 17.14

Follow-up of a Situation Flagged for Subsequent Reassessment

This exhibit supports the observation in the text but is not representative of all cases.

Consider the case of an individual who was the victim of an automobile accident in 1991 and whose application for benefits was accepted in the same year. The medical certificate submitted with the application stipulated that, although the individual was not capable of working in the short term, it was probable that he would be able to return to the labour force during the second year following the accident.

The assessor who granted eligibility for benefits to this applicant made a note in the file that the applicant’s state of health should be reassessed in 1992. The follow-up was not done in 1992 as specified. Not until 1995, as part of an independent review for which the file was selected at random, was it discovered that the individual had been back at work since 1992 without informing the Department.

The decision to recover the amounts paid for the time during which the beneficiary no longer met the eligibility criteria was made in August 1995. However, in view of the Work Incentives policy changes effective August 1995, the administration decided later to amend the cease date and allow a three-month eligibility extension in addition to a two-month part-time work period. The letter notifying the beneficiary of the claim was dated January 1996. Overpayments claimed by the administration totalled approximately \$23,800.

As of July 1996, there was no payment agreement signed between the Department and the beneficiary.

of these measures is to maintain benefits for three months after the individual returns to work. However, the three-month eligibility extension is not consistent with the Act, which defines a severe disability as one where a person is incapable regularly of pursuing a substantially gainful occupation. This policy directive establishes a new fundamental design feature for the reassessment function. The impact of this policy directive has not been determined.

17.97 We found that the approach of some organizations in the private sector to reassessment is far more proactive. Exhibit 17.16 describes the approach, which consists of a follow-up of all files where potential for improvement in the situation exists. Those files are generally identified at the initial application. Beneficiaries deemed to have a long-term disability must, at regular intervals, submit a statement of continued eligibility; other beneficiaries are followed up until they return to the labour force. To adopt such an approach would require a cost/benefit analysis, as additional administrative costs as well as a decrease in program costs may be expected.

17.98 Reassessment remains an essential tool for confirming eligibility. It must be as effective as possible, especially

in a context in which the number of clients is rising and activities are being decentralized. Few beneficiaries have in fact been reassessed. More than 160,000 new cases have been accepted over the past three years. The total number of active cases is actually 300,000 and only 14,685 have been reassessed over the last three years. It is difficult to determine how many reassessments should be done until the Department has a better understanding of the clientele profile.

17.99 The reassessment project initiated in 1993 has not yet demonstrated that it would enable the Department to control continued eligibility of all beneficiaries. Most of the prescheduled reassessments are rarely done. Many beneficiaries escape reassessment because of shortcomings in follow-up and in the flagging and selection of files to be reviewed. Our concerns include the low profile of this activity and the possibility that some clients do not notify the Department when they return to work or when their health improves. The risks are high that large sums of money are paid to beneficiaries who no longer meet the Plan's eligibility criteria.

17.100 The Department should:

- **provide follow-up based primarily on information collected at the time an application is accepted;**

In March 1993, employment income was identified from a beneficiary's record of earnings (from Revenue Canada). The recipient had earned income since 1988; his application for benefits had been accepted in September 1987.

In June 1993, the Department received confirmation from the employer that the beneficiary had been back at work since December 1987. It was only at the end of January 1995 that the administration suspended the payment of benefits. In the meantime, the claimant was receiving employment income in the order of \$35,000 per year.

The decision to recover the amounts paid for the time during which the beneficiary no longer met the eligibility criteria was made in July 1995, and the letter notifying the beneficiary of the claim was dated April 1996. Overpayments claimed by the administration total \$59,000.

As of July 1996, there was no payment agreement signed between the Department and the beneficiary.

It is difficult to determine how many reassessments should be done until the Department has a better understanding of the clientele profile.

Exhibit 17.15

Long Processing Time

This exhibit supports the observation in the text but is not representative of all cases.

- **conduct more reassessments and clearly flag the cases to be reviewed; and**
- **heighten the visibility of reassessment as an element of eligibility control.**

Department's response: The Department's approach to reassessment is based on the analysis of various client profiles, to

determine which clients are the most likely to have their benefits discontinued as a result of reassessment. The suggested approach in the Auditor General's Report has already been evaluated. The Department concluded that prescheduled reassessments are not cost-efficient. The rate of termination of benefits for this type of reassessment has proven to be only seven percent of all reassessed cases.

Exhibit 17.16

Proactive Management of
Disability Applications

As part of our examination, we visited private sector organizations that work in the field of disability insurance. In general, most organizations have also experienced important increases in their caseload. In response to the challenges of managing disability, some organizations have adopted a proactive management approach to disability applications. The approach is based on the concept of team management involving:

- (1) medical advisers;
- (2) disability experts; and
- (3) rehabilitation experts.

(1) Medical advisers submit to the disability experts a clear summary of medical information, including:

- interpretation and evaluation of the medical information in the file (e.g. statement of attending physician, report of independent examining physician);
- interpretation of results of investigations done;
- opinion on value of medical treatment; and
- recommendations on dates of subsequent medical visits, activity questionnaires, rehabilitation visits, submission of a physical capacity assessment form or a report by an independent medical examiner, or the exercise of supervision.

(2) Disability experts act as case managers. They handle the settlement process by:

- careful assessment of all information from the employer, the attending physician and other stakeholders;
- detailed description of the disability;
- communication with the other players;
- determination of need for additional information; and
- decision on requesting or not requesting a medical opinion.

(3) The rehabilitation experts play a dual role, in both assessment and rehabilitation by:

- steering treatment toward return to the job market and intervening from the time of the initial application;
- visiting applicants to gain information on the extent of the disability, treatment followed, motivation, possibility of returning to work and vocational retraining;
- visiting attending physicians and workplaces and analyzing work stations with the sole aim of finding ways of enabling applicants to perform their duties more safely and efficiently; and
- preparing a clear, detailed return-to-work plan, for approval by the applicant and the attending physician.

Proactive management emphasizes applicant aptitudes. The team works closely with the applicant, the attending physician and the employer. The ultimate aim is return to work. When there is reason to suspect fraud, supervision/investigation of the applicant is stepped up. Finally, these organizations are beginning to initiate measures to prevent disability.

Source: SunLife of Canada

As a result of the Auditor General's recommendations in an earlier audit, the Department has implemented a rules-based computer system, which will allow for improved identification and use of information for reassessment purposes, collected at the time of application. The Department has already increased the number of reassessments. The reassessment of beneficiaries has increasingly become one of the essential tools for controlling continuing eligibility during the past three years. The identification of cases to be reviewed will be easier with the new technology, now in place.

A recent Treasury Board submission has secured additional resources to enhance the reassessment activities.

Overpayments underestimated

17.101 The Program Results and Integrity Unit conducts studies to provide management with statistically based information regarding the accuracy of Income Security Programs benefit payments. The Unit undertook one study on 1994 payouts and estimated the most likely value of undetected Disability overpayments at \$14 million and estimated underpayments at \$6 million. Although the procedures require a reconfirmation of initial and continuing eligibility, the review is restricted to

examining the current situation. Furthermore, improvement in medical conditions resulting in regained capacity is considered to begin at the time the Department is informed thereof (the person is deemed to have regained the capacity to work only on that date). In general, no other action is taken to determine how long ago the person actually recovered the capacity to work. These are two major reasons why overpayments are not fully estimated, as stated in the objective of the study. Consequently, benefit payments include overpayments. Exhibit 17.17 gives an example of a case that was not subject to reconfirmation.

17.102 The 1995 Study on the Incidence of Disability, which included a review of prior medical decisions, concluded that between 4.5 and 8 percent of the applications accepted in 1994 were not justified. This corresponds to potential overpayments of \$21 million to \$38 million. If this rate were to be applied to all beneficiaries, it could account for significant overpayment amounts. In our opinion, the estimate of \$14 million of overpayments for all beneficiaries is underestimated. It is significant to note that neither penalty nor interest is charged to those at fault.

The beneficiary is deemed to have regained the capacity to work only at the time the Department is informed.

A person who submitted an application in 1990 was denied benefits. In January 1991, the appeals unit reversed the decision in favour of the applicant. At that time, it was considered that there was a sufficient probability of recovery to set a reassessment date at the beginning of the following year.

It was not until 1995 that the Department intervened again and asked for a new medical certificate. The attending physician concluded that, although the "current and recent" condition of the patient might cause discomfort, it was not of sufficient severity to prevent employability. The patient had not seen this physician for a full year.

The Department ceased payment upon receiving this information, without attempting to obtain additional information from the attending physician or another physician to determine the date on which the person actually regained the capacity to work.

Although required information is difficult to obtain, it is necessary to include such a case in the estimate of overpayments resulting from the study.

Exhibit 17.17

Estimation of Overpayments

This exhibit supports the observation in the text but is not representative of all cases.

17.103 The less rigorous the eligibility controls, the greater the tendency of the beneficiaries to consider benefits as a right acquired for life, regardless of any change in their situation. This right, however, should be based on a confirmed entitlement. We acknowledge that to help dispel this myth, the Department has undertaken a direct mail campaign through which all Disability beneficiaries are being sent a letter explaining their responsibility to report a change in their condition or a return to work. The activities of the Unit provide important feedback to management on the levels of estimated mispayments and on corrective remedies to prevent them from recurring.

17.104 The Department should improve the procedures used for estimating Disability benefit overpayments.

Department's response: The currently used methodology for estimating Disability overpayments has been developed by the Department in collaboration with the Office of the Auditor General. The design for this methodology is consistent with the previous Auditor General Report recommendations.

If the Office of the Auditor General has any suggested improvements to the previous methodology, the Department will be pleased to consider any modifications to improve its estimates of the overpayments.

It should also be noted that random reviews were designed to estimate error in the payment base for the full disability beneficiary population in 1994, while the Incidence report concerns new benefit payments. These are two different sampling frameworks. The integration of the conclusions of the two frameworks can therefore not be reliably extrapolated.

Scope of rehabilitation could be expanded

17.105 Within the framework of the National Strategy for the Integration of Persons with Disabilities, the CPP has initiated a National Vocational Rehabilitation Project pilot with the aim of facilitating the return to work of selected beneficiaries who have rehabilitation potential. The number of cases referred to the rehabilitation unit during the last three years totalled 19,556 and 623 of those were selected to undertake a rehabilitation program. To be eligible for rehabilitation, the beneficiary must be medically stable. In cases where the beneficiary's condition is determined to be unstable but likely to improve, the beneficiary is contacted again at a later date, at which time the potential for rehabilitation is assessed again. The project will end in March 1997 and new referrals are limited to beneficiaries requiring short-term rehabilitation. Services to beneficiaries already in the program will continue until their rehabilitation program is completed. The project is currently being evaluated.

17.106 It is reasonable to expect the Department to be involved in rehabilitation. We wish to emphasize, however, that the services offered are restricted to vocational rehabilitation, that is, guidance, training and selective placement designed to enable a disabled person to secure and retain suitable employment.

17.107 In the past few years, many cases of disability have been attributable to new medical conditions for which a diagnosis is difficult to make. Examples include chronic fatigue syndrome, repetitive strain injuries, environmental illnesses and chronic pain syndrome. These cases are now part of the caseload from which

beneficiaries with rehabilitation potential are selected.

17.108 The treatment and management of these illnesses differ from the treatment of traditional disability cases and require more psycho-social interventions. It is no longer a matter of dealing only with a physical problem and its environment, but also of considering the concept of disability as related to the individual, his or her social position and the times we live in.

17.109 Some private organizations that provide services to persons with disabilities (other than CPP beneficiaries) use a proactive case management approach, on the premise that an approach based solely on vocational rehabilitation is insufficient (see Exhibit 17.16). These organizations have observed that time, the willingness to improve the current situation and adequate treatment all have a positive influence on people. These aspects are all considered in today's psycho-social approach to rehabilitation. The emphasis is on the candidates' potential for recovery, rather than the disability. The objective is to help them, in a positive manner, to improve their condition and enhance their capacity.

17.110 The need for early intervention in rehabilitation is generally recognized. The CPP is at a clear disadvantage here, as the applications for benefits are usually submitted after other available benefits (for example, accumulated sick leave from an employer and sickness benefits available from employment insurance) have been exhausted. Other factors also contribute to delaying the time at which the rehabilitation unit is informed of a potential client's existence:

- application processing backlog of up to three months;

- acceptance of late filers (for example, retroactivity);
- significant number of cases that go to appeal, where processing time is far longer; and
- regionalization of functions.

17.111 Beneficiaries selected have the option to undergo a vocational evaluation. Persons who undertake a rehabilitation program do so on a fully voluntary basis, with the understanding that they will lose their entitlement to benefits whether or not a job is found on completion of the program. According to the administration, some candidates drop out of the program before completing it for fear of subsequently failing to find a job.

17.112 Though the Plan allows the administration to penalize those who refuse to participate in rehabilitation, it is rare that it does. The reasons given for refusing need to be analyzed with a view to taking appropriate corrective measures. While only individuals who are truly interested use the service, all beneficiaries must be treated equally. The Department needs to ensure that those who enter rehabilitation run no more risk than those who choose not to participate.

17.113 If the Department decides to continue rehabilitation activities, it is important that it define the spectrum of services that constitutes reasonable rehabilitation measures and how it will equitably serve all beneficiaries who have a potential for rehabilitation. Should rehabilitation produce the expected results, important savings for the Plan and considerable advantages for the beneficiaries could be achieved.

17.114 The Department should:

- promptly take the measures necessary to maximize the chances of success of rehabilitation; and

The need for early intervention in rehabilitation is generally recognized.

According to the Department, some candidates drop out of the program before completing it for fear of subsequently failing to find a job.

- review the project as a whole to ensure tighter control of continued eligibility for CPP Disability benefits and equitable treatment of all beneficiaries.

Department's response: The Department has already taken measures to maximize the success of its rehabilitation activities. Its approach to rehabilitation, which is very complex and costly, is incremental to ensure maximum efficiency of the process.

Due to the initial success of the National Vocational Rehabilitation Project pilot, which is currently being evaluated, the Department is incorporating rehabilitation activities into its ongoing operations. CPP administration will continue to ensure that the beneficiaries who participate in the rehabilitation program receive full assistance in regaining their capacity to work. While only individuals who are truly interested use the service, all beneficiaries must be treated equitably. The Department is striving to ensure that those beneficiaries who enter rehabilitation programs run no more risk of having their benefits terminated than those who choose not to participate.

Limited exchange of information between key stakeholders

17.115 CPP Disability benefits are designed to replace about 25 percent of the yearly maximum pensionable earnings (YMPE), a figure set by the program as the ceiling for earnings replacement. The YMPE is historically an amount equal to the average industrial wage. Many CPP Disability recipients may also receive pensions or benefits from other income security plans, such as:

- the Quebec Pension Plan;
- provincial and territorial workers compensation plans, which pay benefits to persons disabled on the job;

- private insurers who pay benefits to holders of long-term disability insurance policies; and

- provincial social assistance programs.

17.116 The exact number of beneficiaries who receive payments from a number of plans simultaneously is difficult to assess. The necessary information is not always requested, and not gathered as such in CPP files and records. As a result, the characteristics of these clients cannot easily be established. According to a 1995 Statistics Canada survey conducted for the Department, approximately 25 percent of CPP Disability beneficiaries receive benefits from private insurers; 17 percent from workers compensation plans; and 13 percent from social assistance benefits. Altogether, more than 60 percent of all CPP Disability beneficiaries receive disability income from another income security program.

17.117 There is insufficient exchange of information between the CPP and provincial workers compensation plans or private insurers on medical assessment, decisions rendered, rehabilitation, follow-up and termination of payment to beneficiaries who are receiving benefits from more than one of these organizations.

17.118 The lack of information exchange increases the risk of some beneficiaries receiving benefits to which they are no longer entitled, thus increasing the amount of benefits paid out. The extent of this risk cannot be evaluated, as the data available are incomplete.

17.119 The systematic exchange of information among the CPP, Workers Compensation Boards and private insurers on termination of benefits could improve the detection in a more timely manner of beneficiaries who may no longer be

eligible for CPP benefits, and could reduce overpayments. For example, if we assume that the benefits of 10 percent of co-beneficiaries (beneficiaries of more than one plan) under 55 years of age could be terminated because those individuals are fit for work, benefits paid out by CPP could be reduced by up to \$42 million per annum. While this reduction may not entirely be due to the exchange of information, it could improve the current performance.

17.120 Each plan manages files and incurs expenditures for similar activities with respect to initial and continuous eligibility of beneficiaries. Currently, there is little exchange among plans. This lack of co-ordination means that some beneficiaries must often provide the same information to several plans, which results in useless duplication of effort and cost. The extent of this phenomenon, however, cannot be established from the data available.

17.121 The *Canada Pension Plan Act* governs the disclosure of information gathered on beneficiaries. Apart from exceptions recognized by the Plan, without written authorization from the contributor or applicant, or his or her legal representative, addressed to the Minister, a civil servant cannot disclose the information gathered. However, the practice of obtaining such authorization is becoming more and more widespread, both by the CPP and the other organizations that offer disability insurance.

17.122 The CPP pays retroactive amounts owed to beneficiaries directly to other plans when CPP benefits are to be deducted from benefits granted by the other organization. With the exception of social assistance programs, these payments are made at the request of the

organization in question, according to agreements to this effect.

17.123 The importance of improving the exchange of information with other organizations is recognized by management. It has recently undertaken measures in this regard with Workers Compensation Boards. A federal-provincial agreement is about to be signed with one province and negotiations have started with four other provinces. To date, exchange of information has been limited and done on a case-by-case basis.

17.124 However, there is discussion of forging closer links among CPP, Employment Insurance, workers compensation plans, private insurers and provincial programs. Taking into account the potential for savings through increased information exchange, we urge the Department to step up its efforts to conclude agreements with the remaining Workers Compensation Boards and to undertake similar negotiations with other organizations.

17.125 At the outset, improved co-ordination would foster a better understanding of the profile of co-beneficiaries of the CPP, workers compensation and private insurers. It would also ease the way for concluding other agreements on the exchange of information and on co-operation in joint activities, including cost sharing. Improved co-ordination could also lead to new ways, where feasible, of integrating common activities and improving the efficiency of operations, and could generate savings in both operating and program costs.

17.126 Greater exchange of information on co-beneficiaries between the CPP and private insurers and workers compensation plans could:

- improve service to beneficiaries by reducing the number of medical

Altogether, more than 60 percent of all CPP Disability beneficiaries receive disability income from another income security program.

examinations required and reduce the cost of health services;

- improve the quality of some CPP decisions by providing more information than available at present;
- reduce program expenditures;
- avoid duplication of occupational rehabilitation services; and
- enable timely flagging of beneficiaries no longer eligible for CPP Disability benefits and reduce overpayments.

17.127 The Department should pursue methods of integrating certain common disability-related activities with other organizations and make every effort to:

- better understand the profile and characteristics of co-beneficiaries of CPP Disability, workers compensation and private insurers; and
- conclude exchange of information and co-operation agreements with the above-mentioned groups.

Department's response: The Department has been co-operating with various organizations on joint activities, such as rehabilitation and return-to-work efforts, including cost-sharing of rehabilitation efforts, etc. Exchange of information is ongoing between the Department and Régie des rentes du Québec, several provincial governments and private insurers. It must be noted that the extent of information sharing is restricted by legislation (particularly on privacy issues).

Extensive negotiations took place to complete the first successful agreement with the Alberta Workers Compensation Board (WCB). The success of these negotiations has allowed for a much faster progress in negotiations with other provinces. The Department is currently negotiating agreements with the New Brunswick, Newfoundland, Manitoba,

Nova Scotia and British Columbia WCBs. The exchange of information between the CPP and private insurers would be beneficial and could lead to additional savings. The Department is currently pursuing the possibility of a pilot project to determine the extent of possible savings.

Harmonization with Other Programs

17.128 Most private long-term income replacement plans are integrated with the Canada Pension Plan benefits by providing that the private benefits plus any other disability benefits must not exceed a stated percentage of a beneficiary's normal earnings. Social assistance, as the program of last resort, is available to those who are not eligible for CPP Disability benefits or whose incomes are below what the provincial social assistance programs allow. The 15-week waiting period before Disability benefits are paid corresponds to the Employment Insurance (unemployment) sickness benefit term, thus avoiding overlap.

17.129 The survey data referred to in paragraph 17.116 are not a substitute for regularly collecting information on income and income sources. This information is essential to establish the profile of beneficiaries who stack benefits and are not covered by other plans, and to monitor the situation with a view to harmonizing CPP Disability with other plans.

Limited harmonization with workers compensation plans

17.130 One of the options from the federal-provincial information paper on the Canada Pension Plan, issued in February 1996, was projected to reduce the expenses of CPP Disability by 0.6 percent in the year 2030. This option would reduce CPP Disability benefits to

take account of workers compensation benefits, thus reducing the overlap. According to the paper, “It would also remain consistent with workers compensation principles that the employer — not the CPP — should bear the cost of a work injury.”

17.131 Although the amounts paid by the CPP to beneficiaries of workers compensation plans are appreciable, the CPP has little information from which to accurately assess the number of co-beneficiaries and the amounts paid out. The most recent survey suggests that 17 percent of respondents also receive benefits from workers compensation plans.

17.132 The Canada Pension Plan contains no provision concerning the treatment of disability benefits from other sources, other than provisions allowing for reimbursement of advances paid by other plans. As other programs’ benefits are not taken into account, this makes the Plan a first payer. At the time the CPP was created, most workers compensation programs also took a first payer position, ignoring benefits from other programs. However, in recent years a number of plans have adopted policies aimed at reducing their payments by CPP Disability benefit amounts. The policies vary from board to board.

17.133 In Quebec, the Commission de santé et de sécurité au travail is the first payer in relation to Quebec Pension Plan disability pensions. This has been enshrined in the legislation since 1986. According to the Régie des rentes du Québec, four percent of applicants are denied a disability pension because of this provision. If the CPP had adopted a policy similar to the Quebec policy, costs could have been \$9 million to \$40 million less in 1995–1996, considering that overlap

accounts for between 4 and 17 percent of new CPP beneficiaries. Such a provision would require federal and provincial approval.

Key differences between the CPP and QPP

17.134 The Canada Pension Plan specifies that a province that introduces a general pension plan is one in which the government plans to pay benefits comparable with those contemplated in the CPP. The Plan also specifies that the Minister of Human Resources Development may come to an agreement with the provincial pension plan with regard to persons who are contributors, concerning the calculation and payment of all or part of the benefits, payable in accordance with the legislation in force.

17.135 The CPP administers a number of accounts for contributors who participate in both the Canada Pension Plan and the Quebec Pension Plan (QPP). Under the terms of an understanding between the administrators of the two plans, benefits are granted by the paying organization according to the Act, regulations and procedures in force. The proportion of pensions and benefits payable by each plan is based on the contributions paid into it. In 1994–1995, CPP Disability benefits accounted for 18.7 percent of total payments; for the QPP, they accounted for 9.2 percent.

17.136 Given that the legislation requires that comparable benefits be provided by both plans, it is important to identify the differences between these plans and to evaluate their effects. Exhibit 17.18 shows the difference between the utilization rates of Disability benefits for the two plans. Utilization rate is determined by dividing the average number of beneficiaries by the number of contributors.

As other programs’ benefits are not taken into account, this makes the Plan a first payer.

There are major differences between the CPP and the QPP in contribution criteria and definitions of serious and prolonged disability used to determine contributor eligibility.

17.137 Since 1975, the CPP utilization rate has been higher than the QPP rate. The disparity remained stable from 1975 to 1985; however, since 1985, the QPP utilization rate has remained virtually unchanged while the CPP rate has almost doubled. Analysis of the changes to the CPP since 1985 seems advisable in order to determine their impact on the different patterns of change in the two plans.

17.138 Exhibit 17.19 shows that, between 1986 and 1994, the number of recipients of QPP Disability benefits increased by only 2 percent, compared with 92 percent for the CPP. Furthermore, and also shown in Exhibit 17.19, beneficiaries of the two plans differ by cause of disability, although the two plans have similar purposes.

17.139 Exhibit 17.20 summarizes the legislative and administrative differences between the CPP and the QPP and the possible impact on CPP Disability benefits. In particular, there are major differences between the two plans in contribution criteria and definitions of serious and prolonged disability used to determine contributor eligibility. Since 1987, CPP contribution criteria have been

relaxed, with contributions for two of the past three years now making a contributor eligible. This criterion has been in force in the QPP since 1993. For the purpose of the CPP, prolonged disability is defined as “long continued and of indefinite duration”. “Long continued” disability is interpreted by CPP administration as lasting at least one year. The QPP defines prolonged disability as likely to result in death or lasting indefinitely.

17.140 Because of the significant and fundamental legislative and administrative differences between the CPP and the QPP, care must be taken when comparing the changes in Disability benefits paid out under the two plans. These differences are probably the principal cause of the increasing disparity between utilization rates for the two plans, although other differences may also be important. According to CPP management, the CPP and QPP are considered comparable plans. Changes to both plans over the years have resulted in differences that at times have increased the distinctions and at other times narrowed them.

17.141 The Auditor General of Quebec in his 1995 report observed that Disability applications resulting from some diseases

Exhibit 17.18

Utilization Rate of Disability
Benefits from 1975 to 1994

Year	Canada Pension Plan			Quebec Pension Plan		
	Beneficiaries (average)	Contributors	Utilization Rate (%)	Beneficiaries (average)	Contributors	Utilization Rate (%)
1975	44,236	7,421,009	0.60	9,148	2,663,909	0.34
1980	82,991	8,197,717	1.01	21,299	2,859,718	0.74
1985	132,883	8,721,471	1.52	37,653	2,891,630	1.30
1990	199,565	9,603,392	2.08	43,258	3,167,227	1.37
1991	212,423	9,629,629	2.21	43,281	3,149,253	1.37
1992	229,322	9,429,087	2.43	42,815	3,107,061	1.38
1993	250,700	9,399,394	2.67	43,001	3,069,169	1.40
1994	281,190	9,598,358	2.93	43,879	3,099,861	1.42

Source: Human Resources
Development Canada

such as fibromyalgia and chronic fatigue syndrome are accepted by the CPP and refused by the QPP where such a disease is the main basis for the application. In the case of contributors to both plans, the QPP pays disability pensions to beneficiaries who would have been considered ineligible, if their applications had been processed by QPP officials.

17.142 Although contribution rates to the two plans are identical, we found that the disability-related benefits are not the same as to access or amounts paid. This situation reflects important differences between the two plans. The legislative and administrative factors underlying the observed disparities between the two plans have not been evaluated to determine if benefits remain comparable.

17.143 The Department should:

- identify and evaluate the effects of significant differences between Canada Pension Plan and Quebec Pension Plan Disability benefits; and
- make the results of its evaluations available to federal and provincial authorities in a timely fashion.

Department's response: The Department's recent evaluation of the CPP Disability program is nearing completion. The final report on the results of the evaluation includes an analysis of the differences between the CPP and QPP. It is the intent of the Department to make the results of this evaluation available to federal and provincial government authorities at the earliest opportunity.

When Quebec chose to opt out of the CPP to create its own plan, both plans were

Exhibit 17.19

Beneficiaries According to Cause of Disability, at 31 December 1986 and 1994

Type of diseases	Canada Pension Plan			Quebec Pension Plan		
	1986	1994	Percentage increase	1986	1994	Percentage increase
Mental disorders	15,537 (11%)	43,873 (15%)	182	4,866 (11%)	6,566 (15%)	35
Nervous system	11,739 (8%)	25,961 (9%)	121	4,658 (11%)	6,184 (14%)	33
Circulatory system	38,087 (26%)	45,423 (16%)	19	13,587 (31%)	10,877 (25%)	-20
Respiratory system	7,860 (5%)	9,985 (4%)	27	3,140 (7%)	2,122 (5%)	-32
Musculoskeletal system	43,069 (29%)	97,843 (35%)	127	8,573 (20%)	9,356 (21%)	9
Accidents / poisonings / violence	11,375 (8%)	23,240 (8%)	104	2,223 (5%)	2,431 (5%)	9
Other	19,939 (13%)	37,739 (13%)	89	6,325 (15%)	6,836 (15%)	8
Total	147,606 (100%)	284,064 (100%)	92	43,372 (100%)	44,372 (100%)	2

Source : Rapport sur l'invalidité, comparaison et orientations, Evaluation Branch, Régie des rentes du Québec, September 1995.

Exhibit 17.20

Summary of Key Differences between the Canada Pension
Plan and the Quebec Pension Plan Disability Programs

Legislative Differences	Impact
First payer of record: Since the Canada Pension Plan contains no provision on this matter, CPP is the first payer of record. In Quebec, the Commission de santé et de sécurité au travail has been the first payer of record (before the QPP) since 1986. This position is reflected in the Quebec Pension Plan.	The QPP estimates that the number of cases accepted would be 4% higher if it were not the second payer of record. The CPP estimates that approximately 17% of beneficiaries receive benefits from both provincial workers compensation plans and CPP Disability.
Criteria for contribution: Under the CPP, since 1987, contribution for five of the past ten years or two of the past three years is mandatory prior to the date of disablement. Before 1993, under the QPP, contributions for five of the past ten years or one third of the contribution period was mandatory on the date of application. After 1993, this was changed to five of the past ten years or two of the past three years or one half of the contribution period.	From 1986 to 1993, CPP provisions were less restrictive. According to a QPP estimate, the additional cost would be of the order of 8% and the increase in caseload 14%.
Time for submitting an application: Under the CPP, since 1992, the time limit (15 months) for submitting an application was abolished, where it could be demonstrated that, on the date of disablement, the person had contributed sufficiently to be eligible. Under the QPP, since 1993, the contributor must have contributed sufficiently on the date of disablement. This date cannot exceed 12 months prior to the date of application.	The CPP provision enables the provincial authorities to refer social assistance beneficiaries to determine their eligibility. The Department estimates that, in accordance with the provisions of Bill C-57, grants have been accepted for 22,000 new beneficiaries.
Retroactive payments: Maximum of eight months preceding the date of the QPP application compared to 12 months under the CPP.	Impact not quantified.
Benefits for child of disabled person: Monthly maximum of \$50.95 in 1995 under the QPP compared to \$161.27 under the CPP.	Impact not quantified.
Administrative Differences	Impact
“Serious” disability criterion: Under the CPP, for persons 55 years of age or more, from October 1988 to September 1995, disability was considered serious if it prevented the contributor from doing his own job. This definition is not included in the Plan, as it is under the QPP for persons 60 years of age or over.	According to the QPP, the disability incidence rate is three times greater for persons 60 years of age or over than it is for those between the ages of 55 and 59. The QPP concludes that application of the CPP definition is approximately equivalent to tripling the number of new persons with disabilities among persons between the ages of 55 and 59.
“Prolonged” disability criterion: Under the CPP, a prolonged disability is defined as “long continued and of indefinite duration”. The rule of thumb used to further interpret “long continued” is “one year”. Under the QPP, a prolonged disability is interpreted as “lasting indefinitely”.	Impact not quantified.
Medical reasons: Diseases not recognized by the QPP (with a few exceptions): – chronic fatigue syndrome; – fibromyalgia.	Cases of fibromyalgia went from 743 to 4,575 between 1987 and 1993 under the CPP (from 0.5% to 1.8% of all beneficiaries).
Socio-economic factors: These factors were taken into consideration by the CPP from 1988 to 1995. A reasonable number of job offers should exist in the applicant’s region.	Impact not quantified.

Sources: *Rapport sur l’invalidité, comparaison et orientations*, Evaluation Branch, Régie des rentes du Québec, September 1995 and *CPP Disability Incidence Study*, Human Resources Development Canada, June 1995.

identical, except for the investment strategy. Over the years, changes to both the CPP and QPP resulted in differences between the plans, which at times increased the gap between the plans, and at other times narrowed it. Differences are found in their financing, supplementary benefits and credit-splitting provisions. However, both plans' fundamental elements are identical (same contribution levels, contributory plans financed by employee/employer contributions, and same type of benefits that are similarly structured).

It is essential to note that the Department cannot fully evaluate the effects of the differences between the two plans on its own. This should be a joint effort of both federal and provincial governments.

Information on Results

Evaluation studies provide useful information

17.144 During 1995–96, the Department conducted an evaluation of CPP Disability to assess whether it was meeting its objectives. We reviewed the evaluation studies to assess the quality of the information produced. All of the reports made available to us, including the Interim Report of May 1996, were in draft form at the time of our review.

17.145 Overall, the issues and questions addressed by the studies were appropriate and extensive, and provided useful information on CPP Disability. They included comparisons with disability programs in Quebec (QPP Disability) and in seven other countries, some economic analyses, interviews with stakeholders and a survey of beneficiaries. The latter provided information on the incomes of CPP Disability recipients, the source of such incomes, their education and pre-disability work, willingness to undertake vocational rehabilitation,

obstacles to their returning to work and an indication of how those obstacles might be surmounted. The various studies provided a great deal of background information about beneficiaries and alternative ways of providing public disability insurance. The Interim Report presented a number of proposals for improving CPP Disability, including changes to adjudication and appeals processes and the possibility of separating it from the CPP.

17.146 Although the evaluation reviewed a number of potential factors, it could not fully answer the question of why the caseload has expanded rapidly in recent years. It found that the extent to which economic conditions were a causal factor in the cost increase could not be resolved with available data. For example, administrative data on the eligible population and on applications did not include age and gender distributions. In addition, we noted problems in the evaluation's design and use of data. In general, the evaluation should have done more analysis on how the incidence of disability, which is strongly age-related, interacted with the movement of the baby boom generation through the eligible population and with the increasing presence of women in the working (eligible) population.

17.147 The evaluation concluded that the program benefits have more than met their target of providing 25 percent replacement of income at Yearly Maximum Pensionable Earnings — a ceiling on coverage set at approximately the average industrial wage — and higher replacement for incomes below that level. CPP Disability provides, on average, about half of recipients' incomes; part of the reason for this proportion is that some other income providers are reducing their benefits by the amount of CPP Disability benefits. The extent to which CPP

The evaluation's Interim Report of May 1996 presented a number of proposals for improving CPP Disability.

Disability lowers the cost to other income providers rather than helping the disabled, and the adequacy of disabled recipients' incomes, were not issues in the evaluation (the beneficiary study found that close to 40 percent had incomes below Statistics Canada's low-income cut-off level). The evaluation discussed how contribution requirements and disability criteria affect the total number of beneficiaries, but did not assess fully their impact on eligibility or coverage of particular types or groups of disabled workers, such as older workers.

17.148 CPP Disability does not have precisely defined objectives. This hampered the evaluation's measurement of program success. We expected more discussion and clarification of what CPP Disability is expected to accomplish. For instance, in providing 25 percent replacement of income, CPP Disability also provides higher rates of replacement to those who had lower pre-disability incomes and lower rates to those who had higher pre-disability incomes. There was no discussion of whether this distribution is consistent with CPP Disability goals.

17.149 The evaluation did not discuss major alternatives to providing income to disabled workers, although recommendations to improve administrative efficiency and effectiveness were made. These recommendations were reasonable, although in some instances not directly based on the evidence presented in the evaluation. Examination of the program's rationale did not include examining the extent to which workers are covered by other disability insurance programs, whether disability could be adequately addressed by the provinces or the rationale for public coverage of workers only, rather than all adult citizens, as provided by some of our trading partners. Thus, a number of significant

questions about the success of CPP Disability remain unanswered.

17.150 Further research and program monitoring were recommended by the evaluation team and we concur. We also support its recommendation that the preparation of the evaluation framework should begin now, in time for the next quinquennial review of the CPP. The recommendations did not address the major information gaps related to placing CPP Disability in a demographic context. More information is needed about the size and structure of the eligible population and about applications in relation to the working and disabled populations by age, gender and disability type and severity. These information gaps are significant and a recommendation should have been made to rectify them. In our opinion, the proposed beneficiary case/file review, while potentially useful, will not remedy the major information gaps.

Important performance information gaps

17.151 Our review of the information available on the results achieved by CPP Disability revealed a number of major gaps.

17.152 In spite of the efforts of the administration to explain the increase in the cost of Disability benefits, the impact of the changes in benefit rates and number of beneficiaries has not been quantified. No account has been taken of actual additional disbursements resulting from legislative change, nor has any attempt been made to explain unexpected disparities.

17.153 We found significant gaps regarding eligibility information. The management information systems are limited, data required for sound analysis are not all captured and data on performance measurement are incomplete.

The combined cost of Disability benefits and of administering the benefits is not taken into account. The discounted value of an average benefit — which would enable case-by-case comparison of the cost/benefit ratio — is not known.

17.154 CPP management has introduced guidelines to assess eligibility; however, the impact of these guidelines has not been assessed. We believe that, over the period in question, the impact on applications accepted has been significant.

17.155 Information is lacking on the number of beneficiaries who receive benefits from more than one plan. We recognize that the characteristics of such a group are not easy to define. Each plan manages its own cases, and the information used in processing them cannot be exchanged. However, the lack of information exchange increases costs for all plans and the risk of some beneficiaries receiving undue benefits or receiving benefits when they are no longer eligible.

17.156 The information gaps identified prevent CPP management from adequately accounting for and managing its allocated resources.

17.157 **The Department should take steps to fill the identified gaps in performance information.**

Department's response: The Department has made continuous efforts to document the increase in the cost of Disability benefits in recent years.

- Reports are available on the total cost of benefits arising from referrals of provincial social assistance clients to the CPP in Ontario and New Brunswick (as a result of Bill C-57 legislation).

- CPP Disability caseload growth analysis has reported the steadily declining growth in the disability caseload

over the past six months. The report has shown a decline in the number of CPP beneficiaries for five consecutive months. It has also indicated that the number of upheld decisions at appeals level has increased during the same time.

The impact of the recently revised guidelines for adjudication of benefits on the number of applications is being assessed by the Department. A sample of cases was analyzed to compare a set of previous decisions against the new guidelines to determine any change in the benefit denial rate.

A major quality control review is currently in progress to verify consistency of application of guidelines.

The Department is developing a strategic plan to identify any other information gaps and to document the efforts required to fill these gaps.

Separate report on CPP Disability needed

17.158 The CPP annual report is a particularly important accountability document, given the responsibility to account separately for the Plan and the sharing of responsibilities among departments.

17.159 The importance of CPP Disability in the eyes of the public and parliamentarians is an incentive to gather all significant and relevant information in a single report. Currently, information needs to be extracted from a number of reports, not all of them published simultaneously or in a timely fashion. Is it reasonable to expect to find exhaustive information on CPP Disability in a single report?

17.160 We believe that it is possible to gather the relevant information on results and performance in a single report. The Department can look to examples set by other plans on such matters as how to gather financial information and

**The information
needed to properly
account for the
management of CPP
Disability resources is
presently not
sufficient.**

information on results. Taking into account questions on funding and the many problems raised by various departmental studies and our audit, a single report — or at least a separate chapter — on Disability benefits is essential. With the aim of accounting for its activities, an exhaustive report might include, among other things, the following information:

- statement of vision, mission, values, priorities and objectives;
- comparison of objectives and results with those of similar organizations;
- comparison of actual costs with forecast costs;
- overall resources and costs allocated to administration and benefits;
- service standards, performance indicators, and performance measurement related to operational activities;
- demographic data and long-term projections to be used in determining client profiles (beneficiaries and contributors);
- contribution (costs incurred) of the departments involved in providing services to the CPP;
- referral to other available statistics, where applicable;
- study of trends in average benefits paid by various programs;
- summary of program changes with their costs;
- detailed information on funding and impact on contributions;
- information on future costs of CPP programs and activities;
- additional information from the CPP Advisory Board, where applicable; and
- update on past and current initiatives and impact on results.

17.161 We encourage CPP management to follow the example set by other disability plans. The federal government and the governments of the provinces and territories need complete and timely information on CPP Disability results to make informed decisions. Although CPP Disability has been an integral part of the Canadian social security system since 1966, the information needed to properly account for the management of its allocated resources is presently not sufficient.

17.162 The Department should produce in a separate report timely, complete and relevant information on the significant activities related to CPP Disability to account for the management of its allocated resources.

Department's response: The Department will assess the feasibility of producing a detailed report on the performance and results of the CPP Disability program. Information on CPP Disability is already being published in the CPP Annual Report, CPP Advisory Board Report and in Part III of the Estimates.

A comprehensive action plan is required immediately

17.163 The Department's Study on the Incidence of Disability, completed in June 1995, contains specific recommendations on improving operational efficiency and effectiveness. At the end of our field work, efforts had been made to implement most of the recommendations but the results achieved have not been measured. Insufficient and inaccurate knowledge of the real causes underlying the growth in Disability benefit payments prior to 1995 could explain this delay.

17.164 Early response to the evaluation's Interim Report is encouraged; it contains many recommendations aimed at improving operational efficiency and

effectiveness. This chapter also identifies a number of corrective measures, some of which need to be taken as early as possible to remedy long-standing situations.

17.165 We have seen no progress report on actions taken to date or planned. All those involved with the CPP would benefit from a comprehensive action plan that sets out a shared vision and the priorities, and the responsibilities and co-ordination mechanisms required by the various operational units involved. The action plan should also specify the additional resources needed, if any, for carrying out the measures required for implementing recommendations and for monitoring progress in this regard. We believe that a systematic and integrated approach with clearly defined accountability is needed.

17.166 The Department should develop a comprehensive action plan to establish priorities for the timely implementation and follow-up of required corrective measures to improve operational efficiency and effectiveness.

Department's response: The Department has already taken action on eight recommendations documented in the 1995 Study on the Incidence of Disability. These form the basis for development of a framework for the long-term direction of the CPP Disability program.

An action plan to ensure comprehensive follow-up on all evaluation and audit recommendations is being developed. Responsibility for carrying out this plan has been assigned to a senior manager within the Income Security Programs area.

While many of the strategic issues concerning CPP Disability require further action, there are many operational priorities to which the Department has allocated considerable resources and management attention. Considerable progress has been made in the following

areas to improve service to clients and manage the current CPP Disability program more efficiently:

- *elimination of the backlog of new applications and reduction in the backlog of appeals;*
- *significant reduction of the waiting time between when an application is received and when a decision is made;*
- *regionalization of the adjudication of initial applications, reconsideration and appeals;*
- *establishment of a reassessment program with resources specifically dedicated to addressing the backlog of clients who require a review of their continuing eligibility, including the implementation of new technology for tracking and selecting clients;*
- *improvements to ensure consistency of adjudication decisions;*
- *improved communication and outreach to clients; and*
- *information-sharing agreements with Workers Compensation Boards for exchange of information on mutual clients.*

Conclusion

Common mindset needed to meet the challenges ahead

17.167 Our audit indicates that management needs to continue its efforts to address the identified deficiencies related to Disability eligibility.

17.168 The Department has only recently identified the main factors causing the growth in Disability payments. It was unable, however, to quantify some of these causes because of the lack of data. The Department has made concrete efforts to define corrective measures. Some of these, which have recently been implemented, appear to be

**The deficiencies we
have identified require
immediate action from
management.**

contributing to a reduction in the acceptance rate. It is too early, however, to conclude whether these corrective measures will have a significant and lasting impact on the disability incidence rate.

17.169 Current information is not sufficient to properly manage eligibility for Disability benefits. Data on the measurement of performance (for example, productivity, quality of decisions and speed of service) are not collected or analyzed for management and accountability purposes. Furthermore, the limited importance attached to reassessment activities has diminished the CPP's ability to rigorously monitor continued eligibility.

17.170 One of the consequences of adopting guidelines that have a significant impact on program costs without amending the Act itself is a major disparity between the CPP and the QPP. A number of questions remain unanswered concerning the need to entrench in the Act any new guidelines that may impact significantly on program costs.

17.171 We do not know whether CPP Disability has achieved the objectives set, or whether these objectives are still valid; these are two questions that we expected would be answered by the evaluation. We concur with the conclusions of the evaluation that more research and analysis are required, especially because of the important gaps in demographic information. The combined costs of administration and benefits need to be taken into account for CPP Disability to improve decisions.

17.172 With the administration regionalizing its disability-related activities, the Department cutting back on staff, the major system redesign behind schedule, and the number of applications

remaining high, we consider that the deficiencies we have identified require immediate action from management.

17.173 CPP Disability represents a social insurance against disability and is related to participation in the labour market. The Plan's ability to ensure at least a minimum level of protection depends, to a great extent, on its ability to adapt to future challenges, opportunities and restrictions. For example, the effect of an ageing population on the disability incidence rate and, ultimately, on the funding of the Plan is one of the key challenges. Sound management practices, as described in this chapter, can help the Department address the major challenges ahead.

17.174 The Department's role is to assure contributors and parliamentarians that CPP Disability benefits are paid to those, and only those, who are eligible. When costs of benefits rise, governments are faced with the difficult task of balancing the needs of those who have contributed to the CPP fund — and who are now unable to work due to a severe and prolonged physical or mental condition — and the needs of future generations to ensure that they will not be faced with unreasonable burdens.

Departmental Management Comments on the Chapter

The Department accepts the Auditor General's recommendations. For the most part, they reflect a direction in which the Department was already moving at the time of the audit. For example, the CPP Disability Program management has already increased reassessment activities. Although the Auditor General has raised concerns with respect to our approach to reassessments, the Department believes an incremental approach to reassessments provides the best balance between maintaining current operations, treating

clients in a fair and equitable manner, and being fiscally responsible. Steps are being taken to re-position CPP rehabilitation efforts and to expand co-operative arrangements with private and public sector partners to more effectively serve mutual clients.

Since the 1993 audit chapter on Programs for Seniors, the Department has worked very closely with the Auditor General's Office to develop the current methodologies to determine Income Security Programs mispayments. The current report on the Disability program has raised issues concerning results related to CPP Disability overpayments. The Department is prepared to work with

the Office of the Auditor General to develop a mutually agreeable methodology in this area, recognizing the difficulty in determining the moment a disabled client regains the capacity to work.

In recent years, public and private disability earnings-replacement programs in Canada, the U.S. and Europe have experienced the same dramatic increase in demand and subsequent cost pressures as the CPP Disability Program. The Department is actively in contact with these administrations to learn from them and to incorporate their best practices into the Program to ensure its long-term viability.



About the Audit

Objective

Our audit objective was to assess the adequacy of the management practices related to determining eligibility for Canada Pension Plan (CPP) Disability benefits and measuring results. In particular we sought to:

- determine the extent to which the causes of the recent growth in Disability benefits are known;
- assess the adequacy of management practices for initial determination of eligibility for benefits and for monitoring continuing eligibility of beneficiaries;
- determine how CPP Disability is harmonized and co-ordinated with other disability programs such as provincial workers compensation plans; and
- examine the adequacy of management systems and practices in place for measuring and reporting on the effectiveness of CPP Disability activities to Parliament.

Scope

Our audit focussed on the management of CPP Disability benefits. It covered the causes of the recent increase in the cost of Disability benefits, the management of eligibility for these benefits, harmonization and co-ordination with other disability insurance plans, measurement of results and the quality of the information communicated to Parliament.

We reviewed reports on comparable studies of disability in various countries and audit reports prepared by organizations similar to ours. This review enabled us to appreciate the nature and importance of the challenges and risks related to administering a disability benefit plan. We also examined a number of beneficiary files in order to evaluate the adequacy of current management practices.

Our audit did not attempt to determine whether the CPP is a better plan than the Quebec Pension Plan (QPP) from the point of view of either the beneficiaries or the contributors. However, key differences between the CPP and the QPP Disability were noted to gain a clearer understanding of the causes of the rapid growth in CPP Disability payments.

The quantitative information in the chapter has been drawn from Human Resources Development Canada and other sources indicated in the text. Reasonableness of this information has been examined but not audited.

Criteria

The analysis of the causes of the increase in the cost of CPP Disability benefits should be based on relevant, reliable and complete data. Where appropriate, relevant corrective measures should be taken in a timely manner.

Eligibility for benefits should be established on the basis of relevant and complete information. Disability benefits should be managed with due regard to economy.

Reassessment should be carried out, when deemed appropriate, to ensure continuing eligibility. Rehabilitation measures should be taken when considered effective.

Activities and decisions should be co-ordinated with other disability insurance plans when necessary.

The objectives achieved and the results obtained with CPP Disability benefits should be evaluated comprehensively. The information communicated to Parliament should be relevant, reliable, understandable and timely.

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September 1996

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Chapter 18

**Revenue Canada and
Department of Finance**

**Excise Duties and Taxes on
Selected Commodities**

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Assistant Auditor General: *Shahid Minto*
Responsible Auditors: *Jim Ralston and Michael Adibe*

Revenue Canada and Department of Finance

Excise Duties and Taxes on Selected Commodities

Main Points

18.1 In 1994–95, excise duties and taxes generated some \$6.9 billion, or six percent of gross federal revenue. Of that, 98.4 percent came from the commodities covered in this audit — namely, tobacco, alcohol, motive fuels and jewellery. Various estimates suggest that this excise revenue could have been as much as \$500 million higher were it not for evasion.

18.2 As part of its 1994 anti-smuggling initiative, the government lowered tobacco taxes and increased enforcement resources. Despite the tax reduction and the more vigorous and co-ordinated enforcement efforts of Revenue Canada and the RCMP, evasion of commodity taxes persists. Because of differences in the prices of cigarettes between provinces that lowered their tobacco taxes in response to the federal strategy to combat tobacco smuggling and those that did not, interprovincial smuggling of cigarettes has emerged as a new problem.

18.3 The 1994 Budget Plan forecast that the anti-smuggling initiative would result in a fiscal cost of \$300 million in tobacco tax revenue in 1994–95. Federal revenue from tobacco taxes declined by over \$600 million in 1994–95 compared with 1993–94. Finance's analysis so far has not determined the extent to which this decline is attributable to the reduced tax rate, to evasion or to a change in demand for tobacco products.

18.4 The inherent nature and underlying causes of evasion need to be analyzed more regularly to provide current information to help develop policy and administrative solutions. As well, given the potentially high risk of revenue loss from evasion of motive fuel taxes (which yield the largest amount of federal excise revenue), Revenue Canada and Finance need to systematically assess the extent of fuel tax evasion.

18.5 In the past five years, Revenue Canada has done no excise tax audits of most large licensees (who remit most of the excise taxes) and so risks failing to collect significant amounts of revenue, as audits are statute-barred after four years. The Department recognizes the situation and plans to correct it.

18.6 Revenue Canada maintains high-level aggregate information such as total revenues and number and value of seizures. Finance analyzes the high-level information from Revenue Canada, as well as from Statistics Canada, the RCMP and other sources, to monitor excise revenues. However, Revenue Canada does not on a regular basis collect detailed information needed to monitor, assess and be accountable for its efficiency and effectiveness in administering the commodity taxes and to help Finance's monitoring activities.

18.7 Over the past 21 years, Finance and Revenue Canada have conducted studies and reviews of the *Excise Act*. These reviews have demonstrated the need to revise the Act. The departments are currently doing another joint review. It urgently needs to be completed, as the delay is holding up necessary changes and other desired improvements in the Act and its administration.

Introduction

The *Excise Act* and the *Excise Tax Act*

18.8 The *Excise Act* imposes excise duties on beer, spirits and tobacco products manufactured in Canada. Excise duty liability is established at the point of manufacture, and is based on the quantity of goods produced. The Act makes it illegal to produce products that are subject to excise duty unless the producer is first licensed as a brewer, distiller or tobacco manufacturer; the Act also regulates production, distribution and, in some cases, importation.

18.9 The *Excise Tax Act*, by comparison, imposes excise taxes on tobacco products, motive fuels, wine and jewellery manufactured or imported into Canada as well as on other products not covered in this audit, such as automobile air conditioners and certain automobiles. Excise tax is payable at the time of delivery to the purchaser and is either specific (based on the quantity or weight of product sold) or *ad valorem* (based on the value of the product). Licensing is required, but small manufacturers (those with annual sales under \$50,000) are exempt from both licensing and the requirement to pay excise tax.

18.10 Excise duties and taxes generated some \$6.9 billion in 1994–95, or six percent of gross federal revenue, with 98.4 percent of that coming from the commodities covered in this audit — namely, tobacco, alcohol, motive fuels and jewellery. In 1995–96, excise revenue increased to \$7.5 billion. (See Exhibit 18.1.)

18.11 The principal stakeholders of the excise duty and excise tax measures are the licensees, most of whom are

manufacturers and wholesalers. As required under the Acts, they determine and remit their excise duties and/or excise taxes to Revenue Canada. Importers of certain commodities such as wine and jewellery must pay excise tax on the duty-paid value of the imports. An additional customs duty, equivalent to the excise duty, is imposed on imported beer, spirits and tobacco products.

18.12 The *Excise Act* requires each site to have a licence. So a licensee may have several licences. Exhibit 18.2 shows the number of licences and the amounts and percentages of excise revenue from each of the selected commodity taxes. It also shows the number of major licensees and the proportion of total commodity revenue they paid in 1995–96. The exhibit shows that motive fuels and tobacco, which yielded most of the total excise revenue in 1995–96, had the fewest licensees; jewellery had the most excise licensees but yielded the least revenue.

Revenue Canada's Role in Administering Excise Duties and Taxes

18.13 Revenue Canada is responsible for administering excise duties and taxes, including customs duties that apply to imported commodities. Its mission is to promote and enforce compliance. In addition, at border sites the Department collects provincial alcohol levies for all provinces and tobacco taxes for Ontario and Quebec.

18.14 Administration of excise duties and taxes includes registering and licensing manufacturers and wholesalers; giving them information to help them comply with the legislation; collecting the excise duties and taxes; and monitoring and enforcing compliance through verification, audits, surveillance,

intelligence gathering and analyses,
investigations and examinations.

18.15 The Department estimated that in 1994–95 a group of approximately 70 full-time equivalents (FTEs) and \$3.4 million were dedicated to administering the *Excise Act* (excise duties). Similar figures are not available for the *Excise Tax Act* (excise taxes), as the staff involved also carry out other activities, including administering the goods and services tax (GST), operating Customs Border Services and conducting various audits.

Department of Finance's Role

18.16 Finance is responsible for the design of excise duties and taxes, and for monitoring, evaluating and reporting on their results and recommending changes as appropriate.

Observations and Recommendations

Focus of our audit

18.17 The objective of our audit in Revenue Canada was to determine

Exhibit 18.1

Gross Federal Revenue* from Excise Duties and Taxes, by Commodity, 1993–94 to 1995–96

Commodity	Excise Duty 1995–96 (\$ millions)	Excise Tax 1995–96 (\$ millions)	Total 1995–96 (\$ millions)	% 1995–96	Total 1994–95 (\$ millions)	Total 1993–94 (\$ millions)
Motive Fuels	N/A	4,397.4	4,397.4	58.4	3,819.5	3,667.7
Cigarettes	1,245.9	581.9	1,827.8	24.3	1,787.5	2,373.7
Other Tobacco Products ¹	58.7	58.5	117.2	1.5	130.6	220.3
Beer	542.9	N/A	542.9	7.2	566.2	553.7
Spirits ²	371.4	N/A	371.4	4.9	366.1	366.4
Wines	N/A	108.9	108.9	1.4	109.6	107.7
Jewellery	N/A	52.0	52.0	0.7	59.1	52.8
Sub Total	2,218.9	5,198.7	7,417.6	98.4	6,838.6	7,342.3
Others ³	4.2	114.2	118.4	1.6	109.5	104.9
Total	2,223.1	5,312.9	7,536.0	100.0	6,948.1	7,447.2

Notes:

N/A = Not Applicable

¹ Includes cigars, manufactured tobacco, Canadian raw leaf tobacco and tobacco

² Includes matured spirits and unmatured spirits

³ Includes automotive air conditioners and automobiles

* The above revenue figures exclude customs duty equivalent on imports of beer, spirits and tobacco.

Source: Public Accounts of Canada and Revenue Canada

whether the Department uses appropriate and sufficient controls, systems, practices and information to ensure that excise duties and taxes on the selected commodities are correctly assessed, collected and reported. There are two broad areas of risk to revenue: evasion through smuggling, illegal or unlicensed production, diversion and other means; and failure by licensed producers to pay the right amount of excise duties and taxes. Because the greatest risk of excise revenue loss stems from evasion, principally by smuggling (see Exhibit 18.3), a corollary objective of our audit was to determine the adequacy of Revenue Canada's approach to combatting it and to review the results the Department has achieved. Our objective in auditing Finance was to determine whether it monitors and evaluates the tax measures

adequately. Full details on the audit objectives, scope and approach can be found at the end of the chapter, in **About the Audit**.

Efforts to Combat Evasion Have Been Strengthened but Evasion Persists

Steps taken to identify unlicensed manufacturers and protect revenue

18.18 Typically, evasion of excise duties and taxes is a problem associated not with licensees but with those who should be licensed and are not. Compliant members of the industries concerned would expect Revenue Canada to ensure that non-compliant members are brought to compliance. If the Department fails to do this, compliant members are, in effect, punished for being "good citizens" by

Exhibit 18.2

Number of Licences, Major Licensees and
Excise Revenue, by Commodity, 1995–96

Commodity	All Licences			Major Licensees		
	Number of Licences	Revenue (\$ millions)	Percent of Total Revenue	Number of Major Licensees	Revenue from Major Licensees	Percent of Commodity Tax Revenue
Motive Fuels	71	4,397.4	58.4	10	3,984.0	90.6
Tobacco	92	1,945.0	25.8	3	1,702.0	87.5
Beer	269	542.9	7.2	3	477.6	87.9
Spirits	98	371.4	4.9	12	328.8	88.5
Wines	105	108.9	1.4	11	41.9	38.5
Jewellery	890	52.0	0.7	15	12.4	23.8
Others	55	118.4	1.6	N/A	N/A	N/A
TOTAL	1,580	7,536.0	100.0	54	6,546.7	86.9

Motive fuels and tobacco, which yielded most of the excise revenue in 1995–96, have the fewest number of licensees.

Jewellery had the most excise licensees but yielded the least revenue.

Excise duty licences are issued for each production site, while excise tax licences are issued to the business entity.

N/A = Not Applicable

Source: Revenue Canada

SUMMARY OF OBSERVATIONS ON EACH COMMODITY TAX

Tobacco Products

Federal tobacco tax revenue in 1994-95 was \$1.9 billion, second only to fuel tax revenue. This revenue declined between 1991 and 1994 largely due to smuggling.

Cigarette smuggling had risen dramatically by 1993, resulting in estimated revenue losses to the federal and provincial governments of over \$2 billion in that year and causing serious concern at both levels of government.

To deal with the problem, the government launched the anti-smuggling initiative, which included a drastic reduction in tobacco taxes and increased enforcement resources for Revenue Canada and the RCMP. This initiative has contributed to a decline in smuggling in Ontario and Quebec — provinces that reduced their tobacco taxes also. However, because of differences in the prices of cigarettes between those provinces and others that did not reduce their tobacco taxes, interprovincial smuggling of cigarettes (for example, by mail, particularly to the Western provinces) has emerged as a new problem.

Revenue Canada is working closely with the Western provinces to solve this problem in co-operation with other agencies, such as the RCMP and the Department of Justice.

Alcohol

In 1994-95, revenue from excise duty on beer amounted to \$566 million and on spirits \$366 million; revenue from excise tax on wine was \$110 million. Revenue from beer has been increasing but from spirits is declining; from wine it has remained about the same since 1992-93.

The major problem with respect to alcohol is evasion of excise duty on spirits and excise tax on wine. Evasion is accomplished largely through smuggling and by diversion of exports and illegal

production. Revenue Canada estimated that revenue loss was as high as \$110 million in 1993 (excluding wine; the Canadian Wine Institute and the Liquor Control Board of Ontario consider evasion of wine tax through illegal production to be significant). Although the anti-smuggling initiative was also directed at alcohol smuggling, the problem persists.

The Association of Canadian Distillers has expressed its concern to the government that if the structure and level of excise duty on spirits are not changed, the substantial smuggling of alcohol will continue, particularly in Ontario and Quebec.

Jewellery

Revenue from jewellery excise tax in 1994-95 amounted to \$59 million, the lowest among all the commodities covered in this audit.

Studies by both Finance and the industry indicate that there is extensive evasion and avoidance of jewellery excise tax through underground activity, resulting in a federal excise revenue loss of some \$30 million annually.

There are also particular problems in administering the jewellery excise tax. Officials of Revenue Canada directly involved in administering the jewellery excise tax advised us that it is very difficult to apply the tax to all jewellery manufacturers who should be paying it. For example, we note that jewellery manufacturers who need to be licensed do not always apply voluntarily to Revenue Canada for licensing, and certain problems limit what excise officers can do to identify unlicensed jewellery manufacturers.

Revenue Canada has carried out blitzes, albeit not systematically and consistently across the regions, to identify potential licensees and to counter jewellery tax evasion. Notwithstanding that its efforts

have surfaced over 100 potential licensees, it is difficult for the Department to have a universal jewellery excise tax roll — an essential element for fair tax administration.

Finance recognizes that the design of the jewellery tax is similar to that of the previous federal manufacturers' sales tax and shares many of the latter's structural weaknesses.

Given these problems and the importance of maintaining a fair tax structure, Finance needs to continue to assess and seek solutions in consultation with the industry.

Motive fuels

Revenue from fuel taxes in 1994-95 amounted to \$3.8 billion, or 55 percent of total excise revenues, the largest amount of all the commodities. Revenue has been increasing annually since 1992-93.

Evasion of the taxes is done through diversion of fuel from tax-exempt to taxable uses, diversion of products destined for exports, and illegal production. Some provincial and U.S. state governments consider fuel tax evasion to be a serious problem.

Both Finance and Revenue Canada are aware of the various schemes used to evade fuel taxes. Finance's estimate of revenue loss (\$55 million) cannot be considered definitive because of limitations in the data from which it was derived. Revenue Canada is participating in a federal-provincial project aimed at determining the extent and nature of fuel tax evasion across Canada.

A particular problem exists with the administration of the fuel tax exemption provisions. Revenue Canada does not maintain and analyze data to help it administer the exemption provisions and to assess the extent of evasion through their improper use.

having their businesses placed at a competitive disadvantage.

18.19 Although Revenue Canada does not have a systematic process to detect potential licensees who fail to apply for a licence, such as its Non-Filer Program for detecting those who do not file income tax returns, it has taken some steps to identify unlicensed manufacturers and to protect revenue. For example, even though there are problems in identifying unlicensed jewellery manufacturers, the Department has carried out blitzes to identify potential licensees. As well, although “U-brews” are not required to be licensed, Revenue Canada conducts occasional inspections of U-brews to determine if they produce beer or wine for sale and if such sales of wine have passed the \$50,000 threshold beyond which a licence is required. Furthermore, it has developed administrative procedures for controlling revenue from the sale of diesel fuel for tax-exempt use.

18.20 Purchasers sometimes divert tax-exempt fuel to be used for purposes that would attract excise tax (such as fuelling internal combustion engines). If

they do, they are required to remit excise tax for the amounts diverted to taxable use. However, purchasers of fuel for exempt use are not legally required to be licensed. To control revenue from the sale of diesel fuel for tax-exempt use, the Department permits the purchaser to sign each request for exemption (except for blanket certificates where licensed manufacturers or wholesalers repeatedly order goods for resale). In addition, it has established a system whereby bulk dealers who regularly sell heating fuel as diesel fuel are given an account number and are automatically sent a return to account for these sales. Currently the Department has identified 273 such accounts and included them in its Excise Commercial System.

Enforcement has been strengthened

18.21 Revenue Canada’s enforcement activities to address evasion include investigations, intelligence (gathering and analyzing intelligence and recommending enforcement actions), interdiction, inspections and examinations of goods and travellers. In addition, the Department has established the underground economy

Commodity	Revenue ¹ (\$ millions)	Estimates* of Revenue Loss from Evasion (\$ millions)	Audit Assessments (\$ millions)
Motive Fuels	3,819.5	55 to 110	—
Tobacco	1,918.1	200 to 280	0.9
Beer	566.2	—	1.0
Spirits	366.1	150 to 200	0.5
Wines	109.6	—	—
Jewellery	59.1	20 to 40	—
Others	109.5	N/A	N/A
	6,948.1	425 to 630	2.4

The greatest risk of excise revenue loss stems from evasion, principally by smuggling.

Notes:

— Estimates not available
N/A = Not applicable

Sources: ¹ Public Accounts of Canada
* Judgmental updates derived from estimates of previous years

Exhibit 18.3

Revenue, Estimates* of Revenue
Loss from Evasion, and Audit
Assessments, by Commodity,
1994–95

The government's anti-smuggling initiative is an important part of the effort to combat evasion of excise duties and taxes.

initiative, and is currently participating in the government's anti-smuggling initiative, which is particularly relevant to combatting evasion of the selected commodity taxes.

18.22 Anti-smuggling initiative. On 8 February 1994, the Prime Minister announced the anti-smuggling initiative to deal with the serious problem of tobacco smuggling, which had risen dramatically by 1993. Estimated revenue loss to the federal and provincial governments was over \$2 billion in that year, causing serious concern at both levels of government.

18.23 The anti-smuggling initiative is a three-year program that will end on 31 March 1997. It involves a number of measures to curtail smuggling, including increased enforcement, health promotion, the lowering of excise tax on tobacco products, a surtax on tobacco manufacturers, and a reimposition of an export tax on tobacco products. Besides Revenue Canada, others involved in the initiative include Health Canada, Justice, Solicitor General, Finance, RCMP and the provinces.

18.24 Resource allocation. Revenue Canada was allocated \$45 million, which included 413 full-time equivalents (FTEs), in 1994–95, the first year of the anti-smuggling initiative. Of this amount, approximately \$38 million including 350 FTEs was allocated to Customs Border Services. The balance of resources was allocated to Excise/GST for additional audits to ensure that applicable tobacco excise duties, taxes and rebates are paid. (By comparison, in the same year, the RCMP was allocated \$73 million dollars for the initiative, including 390 FTEs.)

18.25 Anti-smuggling enforcement strategy. Revenue Canada has used its

additional anti-smuggling resources to strengthen ongoing enforcement activities in the regions. The Department's enforcement strategy includes: conducting land border blitzes; expanding to 24-hour service at selected border crossings; increasing the number of commercial inspections and examinations; opening temporary offices; and increasing intelligence gathering and analysis.

Co-operation and co-ordination with the RCMP vary but are generally good

18.26 Combatting evasion requires sharing knowledge and intelligence and working with other organizations in a concerted and co-ordinated way.

18.27 Revenue Canada has established working relationships with the RCMP, provincial police forces, and other organizations such as U.S. Customs and the U.S. Bureau of Alcohol, Tobacco and Firearms. For example, it has signed co-operation agreements with the provinces to develop measures that address the underground economy, tax evasion and smuggling, to help ensure fair and efficient tax systems and to increase voluntary compliance. It has also signed a memorandum of understanding with the RCMP. As well, Revenue Canada works with the RCMP in Joint Forces Operations to combat evasion.

18.28 Generally, co-operation and working relationships with these organizations appear to be good across the regions. But among the regions and at different levels in Revenue Canada there are wide variations in the degree of co-operation with the RCMP. In the Atlantic and Pacific regions, co-operation with the RCMP and the provincial governments is particularly good; it is generally good in the Quebec and northern Ontario region, and especially good in the Cornwall area. The factors that appear to

have contributed to successful co-operation in these regions include:

- liaison officers in each organization to exchange required information;
- recognition that while the priorities of the organizations may differ from time to time, the overall or common interest of the country (curbing evasion) is paramount;
- regular meetings that provide a forum for informal exchange of information and for resolving problems; and
- the political will to deal with the issues, as reflected, for example, in agreements and memorandums of understanding.

18.29 In areas where there is good co-operation with the RCMP, significant results have been achieved in seizures and prosecutions. Co-operation could be improved further if the lessons learned in those areas were applied in other locations.

Anti-smuggling initiative and heightened enforcement show initial success

18.30 Early indications are that the anti-smuggling initiative has had initial successes.

18.31 In its 1994–95 report to Treasury Board on the initiative, Revenue Canada focussed on seizures, stating that its activities have resulted in contraband seizures of significantly increased dollar value. However, the seizure statistics are related to neither resources nor revenues, and the report provides no estimates of additional revenue collected or revenue loss forestalled, noting that it is difficult to disentangle the effects of the significant cut in federal and provincial cigarette taxes from those of increased enforcement. The Department states that it is difficult to make this type of correlation.

18.32 Exhibit 18.4 shows that tobacco seizures declined substantially in 1994–95, suggesting (as noted in an internal report of the Department) that the government's anti-smuggling initiative has

In areas where there is good co-operation with the RCMP, significant numbers of seizures and prosecutions have resulted.



Customs and the RCMP engage in co-operative marine patrols in the Maritimes to deter alcohol smuggling (see paragraph 18.28).

dramatically reduced the threat posed to the Canadian economy by the smuggling of tobacco products. As well, by increasing enforcement at the border, Customs officers help deter smuggling and improve the Department's management of the smuggling risk.

18.33 When it announced the initiative, the government recognized that there would be a fiscal cost in both 1994–95 and 1995–96, but expected net savings of \$20 million in 1996–97.

18.34 Finance continues to monitor tobacco shipments and excise revenue, and Revenue Canada has embarked on an evaluation of the anti-smuggling initiative. We are concerned, however, that the departments have not fully reviewed the cost and benefits of the anti-smuggling measures. For example, the 1994 Budget Plan forecast that the anti-smuggling initiative would result in a \$300 million decline in tobacco tax revenue in 1994–95. *Ex post* federal revenue from tobacco taxes declined by over \$600 million in 1994–95 compared with 1993–94 (see Exhibit 18.1). Finance's analysis so far has not determined the extent to which this decline is attributable

to the reduced tax rate, to evasion, or to a change in demand for tobacco products.

Evasion is still a problem

18.35 Despite the reported initial successes of the anti-smuggling measures, evasion remains a serious and persistent problem (see Exhibit 18.5).

18.36 Tobacco. Tobacco seizure statistics indicate that the anti-smuggling initiative has contributed to a decline in smuggling into central Canada. However, Revenue Canada projected that 1.4 billion exported cigarettes would be smuggled back into Canada in 1995. This would mean a loss of about \$52 million in federal excise revenue.

18.37 As part of its 1994 anti-smuggling initiative, the government lowered tobacco taxes to reduce the price differential between Canada and the United States, and encouraged the provinces to do the same. Some provinces agreed and lowered their tobacco taxes, while others did not. Because of differences in the price of cigarettes, particularly between those provinces that lowered their tobacco taxes and those that did not (see Exhibit 18.6), interprovincial smuggling of cigarettes has emerged as a new threat to revenue, primarily

Exhibit 18.4

Enforcement Results Achieved in 1993–94 and 1994–95

Commodities	Seizures (number)		Value (\$ millions)	
	1993–94	1994–95	1993–94	1994–95
Tobacco	14,230	6,700	4.1	1.0
Alcohol	14,876	10,323	3.0	5.5
Total	29,106	17,023	7.1	6.5

Note: The above does not include seizures by the joint forces operation (J.F.O) across Canada that resulted in 683 seizures of tobacco with a value of over \$10 million; 450 prosecutions were also initiated.

Source: Revenue Canada

Exhibit 18.5

Evasion Persists

Media reports show that while the increased enforcement efforts by Revenue Canada and the RCMP are achieving results, evasion persists.

Jail and \$1M fine in huge gas scam

City man charged in \$1.7m fuel tax case

A BURLINGTON man is among six people charged with fraud and theft in connection with the importation of fuel from the U.S.

Police say taxes was paid. Member

Police anti-rackets branch, the Ministry of Finance special investigation branch and Revenue Customs and Excise

mastermind a multimillion-dollar series of fuel-tax yesterday was 1/2 years and to repay \$1 mil-

taxpayers of more than \$9 million since 1987.

But the Mississauga businessman, who pleaded guilty to fraud, conspiracy and environmental charges.

Justice David Watt issued a compensation order of \$1 million against Sungaila, who was snared after eight years of work by the OPP, RCMP, FBI and various Queen's Park

Sungaila.

Family charged in gold smuggling

Three people face a string of charges for smuggling or attempting to smuggle more than \$1.2 million in gold jewelry across the Rainbow Bridge in Niagara

All of the 22-carat gold jewelry was seized at the bridge, along with four cars police said were used to smuggle the jewellery into Canada, the

release yesterday.

The bust was result of a joint operation by RCMP, Revenue Canada, Canadian and customs authorities

Canada Customs Agents and RCMP Officers Join Forces to take a Nibble Out of the Lucrative 'Business' of Smuggling Contraband Smokes and Booze Into Ontario

A young native man climbs behind the wheel of a big sedan on Cornwall Island on the Akwe-

sasne reserve. It is dusk and the end of a sunny, warm day in eastern Ontario.

Booze smugglers busted

Mounties smash huge ring shifting contraband liquor

The RCMP say more than 1,000 cases of U.S. booze were being sold daily — tax free — in the Metro area by members

organized crime groups — including Chinese and Vietnamese gangs — were behind the smuggling of millions

The Mounties arrested more than 80 people Tuesday and issued warrants for 15 others after simultaneous raids

DE L'ALCOOL DESTINÉ À L'EXPORTATION DÉTOURNÉ!

Une enquête policière a mené à la découverte d'un véritable racket mis au point par des bandiers qui détournent vers des bars du Québec l'alcool destiné à l'exportation à l'étranger.

Il a été démontré que l'alcool devait être transporté en avion et avait été tout simplement

C'est une somme de près de 2 000 000 \$ en taxes d'accise que le gouvernement fédéral est en train de collecter, a appris Le Journal de Montréal.

Affirmant que le dossier n'est pas encore complet, les autorités refusent de commenter ce dossier, pour l'instant du moins.

Amendes records à des contrebandiers

21 membres d'un réseau sont condamnés à verser 4 millions à l'État

En plus de se voir confisquer pour 822 000 \$ de biens, un précédent dans les annales judiciaires au Canada, 21 membres d'un gang de contrebandiers d'alcool et de tabac ont écopé d'amendes totales

tionnelles prononcées lundi par le juge Gérard Groulx, de la Cour du Québec à Valleyfield, marquant une autre étape dans les procédures judiciaires intentées contre cette organisation d'en-

L'arrestation de 21 personnes, dont Marion Harlé, le chef, a permis le démantèlement de l'un des plus importants réseaux de contrebandiers d'alcool et de produits de tabac oeuvrant dans la

La FTQ dénonce la contrebande d'alcool

Les syndicats de la FTQ qui oeuvrent à la Société des alcools et dans les distilleries affirment que 1200 emplois ont été perdus dans ce secteur en 10 ans à cause de la contrebande. Ils demandent au gouvernement d'abaisser les taxes et d'accroître la surveillance policière.

La contrebande d'alcool est devenue un fléau. Les importations d'alcool en provenance des États-Unis représentent la moitié des ventes de spiritueux au Québec, soit une bouteille sur deux. En 1987, il y avait hier une demi-douzaine de représentants syndicaux, basant sur une étude réalisée pour le compte de l'Association des alcools.

RCMP seize Sago smokes

Edmonton RCMP have charged seven people and seized more than 5,000 cartons of tax-free cigarettes allegedly smuggled into Alberta from an illegal tobacco manufacturing plant on an Ontario Indian reserve.

Sago brand cigarettes are tax-free and have been selling in the prairie Atlantic provinces for at least a year, RCMP say. Sago means "smoke" in Mohawk. The cigarettes are manufactured by a native-owned

Grand River Enterprises which operates on Six Nations, RCMP say.

Cigarettes by mail "bargain" goes up in smoke

B.C. smokers buying mail-order cigarettes from Ontario or Quebec are getting it with provincial tax bills ranging from \$100 to more than \$1,000.

B.C. tax officials get the names of cigarette buyers using information from courier companies or government sources. The consumer taxation branch then sends out notices asking people to pay the tax.

Cigarettes are about \$18 a carton cheaper in Central Canada because of lower provincial taxes in Quebec and Ontario. "There's a large discrepancy in the tax rate," David Longman, director of regional operations for B.C.'s consumer taxation branch, said Tuesday. "So it makes it very attractive when these people advertise that you can buy your cigarettes for \$29

**Interprovincial
smuggling of
cigarettes has
emerged as a new
threat.**

provincial revenue. Of particular concern to the Western provinces is the illegal interprovincial movement (for example, by mail) of tobacco products originating from Ontario and Quebec, which is reportedly contributing to a decline in their tobacco tax revenues. Revenue Canada is working closely with the Western provinces to solve this problem in co-operation with other agencies, such as the RCMP and the Department of Justice.

18.38 Alcohol. While the number of seizures of alcohol by Revenue Canada declined by about 30 percent from 1993–94 to 1994–95, their total value increased by 83 percent. The Department has predicted that alcohol smuggling will continue to be a problem in Canada. The Department needs to monitor the situation

to prevent the problem from escalating, as in the case of tobacco.

18.39 Motive fuels. Revenue Canada's fuel threat assessment in the Pacific region concluded that there is a risk of diesel fuel tax evasion through inaccurate description and diversion of fuel for purposes that would otherwise attract a tax. While neither Revenue Canada nor Finance has systematically assessed the extent of fuel tax evasion on a national basis, Finance has noted that the combined level of federal and provincial fuel taxes provides an incentive to evade them, and that the opportunity for evasion continues to exist.

18.40 Enforcement alone cannot eliminate evasion; it will continue as long as there is profit to be made. It is therefore important that in addition to assessing and

Exhibit 18.6

Price per Carton of Cigarettes in Each Province,
October 1994



Source: Statistics Canada – Cat. No. 62-010

monitoring the extent of evasion, its inherent nature and underlying causes be analyzed regularly to provide decision makers with more current information they need to develop policies that will address the problem (see Exhibit 18.7).

Need for more frequent and comprehensive assessment of the evasion problem

18.41 Knowing the causes, nature and scale of evasion is critical to developing an appropriate enforcement strategy. Exhibit 18.8 shows the methods of evasion of particular commodity taxes. It shows that distilled spirits have probably overtaken tobacco as the major smuggled commodity. It also shows that evasion of jewellery excise tax is accomplished by the greatest variety of methods.

18.42 Revenue Canada's Intelligence Services Division has assessed the magnitude of evasion of specific commodity taxes through smuggling. The Division carries out periodic research studies that provide quantitative assessments of tobacco, liquor and jewellery smuggling. As well, the Division has carried out risk analyses relating to, for example, fuel tax evasion in the Pacific region and the risk of

smuggling at the port of Four Falls in New Brunswick.

18.43 Typically, these studies report on methods of smuggling, and estimate the amount and value of commodities smuggled into Canada as well as the ensuing loss of revenue. For example, in 1994 the Division estimated that the loss of federal excise duty and sales tax on smuggled alcohol in 1993 was between \$85 million and \$110 million. Also, the Division estimated that federal revenue lost through tobacco smuggling in 1993 was \$1.2 billion.

18.44 Estimates of the extent of contraband tobacco, spirits and jewellery have also been prepared for various time periods by others including Finance, industry associations and consulting firms, using various methodologies. These estimates vary considerably for some commodities, as in the case of spirits. Estimates of the magnitude of smuggling, illegal production or diversion of any commodity are highly sensitive to the assumptions employed.

18.45 We reviewed the methodologies and the reasonableness of the available estimates of revenue losses. To provide a current perspective, we updated them where feasible and we derived, partly on a

Enforcement alone cannot eliminate evasion; it will continue as long as there is profit to be made.

In 1993, federal revenue lost through tobacco smuggling was estimated at \$1.2 billion; between \$85 million and \$110 million was lost on smuggled alcohol.

- Size of the tax wedge (the difference between the prices of a particular commodity in different jurisdictions, created by difference in tax rates), which provides the profit incentive for smuggling
- Market size or demand for a commodity
- Value of a commodity relative to its weight
- Variety and spread of channels for distributing a commodity
- Provisions for exemption from a tax measure that provide opportunities for their misuse or abuse
- Efficiency and effectiveness of administration of the taxes
- Nature and extent of co-operation with other enforcement agencies
- Severity or lightness of penalties for evasion
- Valuation of commodities such as jewellery for which the tax is *ad valorem*

Exhibit 18.7

Examples of Factors That Could Influence Evasion of a Commodity Tax

judgmental basis, plausible ranges of estimates for 1994. These are shown in Exhibit 18.3.

18.46 The various estimates indicate that revenue losses from evasion of the selected commodity taxes declined from a high range of between \$1.3 billion and \$1.7 billion in 1993 to a range of between \$425 million and \$630 million in 1994. This means that for every \$100 of excise revenue collected from those commodity taxes in 1993, another \$20 was lost through evasion; this figure was down to \$7 in 1994. The decline was largely due to the tobacco tax reduction and the consequent decline in cross-border smuggling of cigarettes. Revenue Canada estimates that federal revenue loss from cigarette tax evasion alone fell from a high of \$1.2 billion in 1993 to \$200 million in 1994.

18.47 These estimates do not include losses to provinces (which could be in the hundreds of millions of dollars) resulting from evasion of provincial taxes on those commodities. Nor do they include losses from evasion of income tax, GST and

payroll taxes; evasion of one tax is usually accompanied by evasion of others. In assessing the evasion problem, Revenue Canada needs to continue to work more collaboratively with the provinces and other jurisdictions, as appropriate, to develop more current estimates of the scale of evasion for each commodity, and more solid estimates of revenue loss for each and all federal taxes.

18.48 Estimates of the scale and the revenue implications of evasion are not prepared regularly (for example, annually or every other year) to track trends. Although it has estimated revenue losses from evasion of alcohol, tobacco and jewellery excise duties and taxes, Revenue Canada has not done so for motive fuels. Nor has it reported these estimates to Parliament to inform it about the magnitude and financial implications of the evasion problem and provide accountability for the degree of success in containing the problem.

18.49 We are concerned that evasion activities related to motive fuel taxes have not received the attention warranted by

Exhibit 18.8

Methods of Evasion

	Spirits	Wine	Beer	Tobacco	Gasoline	Diesel	Jewellery
Cross-border Smuggling	H	H	L	M	M	M	H
Interprovincial Smuggling				H			
Illegal Production	L	M	M	L	L	L	H
Diversion of Exports	L	L	L	L	M	M	H
Conversion of Untaxed to Taxed						H	
Undervaluation/Skimming							H
Misclassification							H

Ranking of method of evasion: (H = High, M = Medium and L = Low)

Distilled spirits have overtaken tobacco as the number one commodity for smuggling. The evasion of jewellery excise tax is accomplished by the greatest variety of methods, making the tax very difficult to administer fairly.

the potential size of the problem. Motive fuels account for nearly 83 percent of total federal revenue from excise tax. Work done by the Provincial Auditor of Ontario suggests that revenue losses from motor fuel scams could be substantial. Revenue Canada has not estimated federal excise revenue lost as a result of fuel tax evasion.

18.50 In the U.S., the Department of Transportation works together with agencies of states where fuel tax evasion is prevalent to assess the magnitude of the problem and address it. It reported that “the current level of gasoline tax evasion is between 3 and 7 percent of gallons consumed, and that the level of diesel fuel tax evasion is between 15 and 25 percent of gallons consumed” and “the total estimated annual revenue loss from Federal fuel tax evasion would be about \$1.3 billion.” If the level of evasion in Canada were assumed to be only 3 percent of the quantity consumed, the revenue loss would be about \$115 million, again suggesting that the actual loss of federal excise revenue is substantial.

18.51 Both Finance and Revenue Canada have been aware of the issue of motive fuel tax evasion and the various schemes used to avoid taxes, including diversion of untaxed fuel intended for export and diversion of exempt heating fuel to taxable uses. Finance has noted that gasoline tax evasion is not a new issue and that it was particularly serious during the mid-1980s; its analysis of motive fuel excise revenues suggests that federal revenue loss was as high as \$55 million in 1994–95. Revenue Canada is currently participating in the Federal-Provincial Fuel Tax Administration Project, an initiative with a primary objective of determining the presence, extent and nature of fuel tax evasion across Canada and in the relevant American states.

No focal point to co-ordinate anti-evasion activities internally

18.52 There are many organizational components within Revenue Canada involved in administering and enforcing excise duties and taxes and in the anti-smuggling and underground economy initiatives. At headquarters, these include: Policy and Legislation Branch; Assessment and Collections Branch; Verification, Enforcement and Compliance Research Branch; Customs Border Services Branch; and Appeals Branch. Involvement in the regions includes excise duty officers in special units at specific district offices, auditors in the Verification, Enforcement and Compliance divisions, and uniformed officers of the Customs Border Services.

18.53 Because the anti-smuggling initiative, the underground economy initiative and the ongoing enforcement activities of Revenue Canada are interconnected, co-ordination is essential to minimize duplication, resolve differences in priorities and promote efficiency and effectiveness.

18.54 While each region reacts to the evasion problem in its area, there is no focal point for co-ordinating the various activities aimed at detecting, identifying and assessing the magnitude of evasion problems, for determining priorities at the national level and reconciling competing regional priorities, and for directing action to address them. Departmental officials advised us that they were in the process of setting up an intelligence advisory committee of assistant deputy ministers. This committee, supported by a Corporate Intelligence Unit, would serve as the focal point for this purpose. At the end of our audit, the committee had not yet been established. Such a focal point is necessary to co-ordinate the battle against evasion of any type of tax: income tax,

Evasion activities related to motive fuel taxes have not received the attention warranted by the potential size of the problem.

Co-ordination is essential to minimize duplication, resolve differences in priorities and promote efficiency and effectiveness.

GST and commodity taxes. We will follow up in future to determine whether the proposed committee serves adequately as this focal point.

18.55 Finance and Revenue Canada should regularly and comprehensively assess the nature, scale and underlying causes of evasion of excise duties and taxes, and the major factors influencing its magnitude, so that trends in evasion can be tracked and the root causes of the problem can be addressed at both the policy and administrative levels, and the appropriate strategies and type and level of effort to combat it can be determined.

Finance's response: The Department of Finance is concerned about the extent of evasion of excise duties and taxes. In collaboration with Revenue Canada, it has assessed in the past, and will continue to do so, the nature, extent and causes of tax evasion. The Department concentrates its resources on areas where there is evidence of significant tax evasion.

Regarding tobacco smuggling, the Department has devoted significant resources to the analysis of the contraband tobacco market. This work provided the basis for the government's National Action Plan on smuggling. The success of the Plan is demonstrated by the dramatic decline in tobacco smuggling since early 1994. The Department's monitoring of revenue collections indicates that tobacco tax collections in 1994–95 followed the track set out in the 1994 Budget Plan and that the estimated fiscal cost of \$300 million was accurate.

The Department has been increasing its efforts to evaluate the nature and extent of the illegal alcohol market. The Department's analysis to date has revealed the difficulty of estimating the magnitude of alcohol smuggling, owing to limited data sources. Its analysis confirms, as paragraph 18.44 of the chapter notes, that

smuggling estimates are highly sensitive to the assumptions employed. Nevertheless, the Department is committed to continuing its evaluation of the extent of the alcohol problem.

Revenue Canada's response: Revenue Canada, in collaboration with the Department of Finance, will continue to enhance its current evasion assessments as they relate to selected commodities and to examine underlying causes of evasion.

18.56 Revenue Canada should:

- continue its enhanced enforcement efforts to combat evasion as part of the government's anti-smuggling initiative, given its reported initial successes and the persistence of evasion as a serious problem; and
- establish a focal point for co-ordinating its anti-evasion activities.

Revenue Canada's response: Revenue Canada in conjunction with the RCMP, Solicitor General and the Department of Justice is currently preparing a request for continued funding for the Anti-Smuggling Initiative that will allow us to continue the program at the current level of activity.

In addition, the Department will continue with other anti-evasion initiatives such as the Tobacco Export Verification Program and the newly implemented Alcohol Control Measures Program, as well as participating in the Fuel Tax Administration Project.

Revenue Canada recognizes that evasion is a serious and continuing problem. The Department will continue to work with its federal/provincial partners, industry and other stakeholders to improve targeting and intelligence and conduct enhanced examinations using contraband detection technology.

Within Revenue Canada, all anti-evasion activities are now overseen by a group of selected assistant deputy ministers who provide advice and direction, across all tax lines, regarding the overall program.

This focus is to be further enhanced by the creation of a new organizational group, the mandate of which will include ensuring appropriate co-ordination of verification and enforcement activities addressing non-compliance, including tax evasion. This new unit will also facilitate the formulation, implementation and assessment of comprehensive strategies across all tax lines to address identified compliance issues.

Excise Audit Strategy and Audit Coverage Are Not Adequate

Approach to excise duty audit and surveillance needs monitoring

18.57 Revenue Canada's overall approach to administering excise duties and the regulatory requirements of the *Excise Act* has evolved. It has gradually moved from close physical control, including maintaining a presence at the licensees' premises, to a new surveillance approach that is essentially a limited-scope review. The new approach has enabled the Department to reduce its excise duty staff gradually from about 450 full-time equivalents in 1975 to the current level of approximately 70. The United Kingdom's Customs and Excise department adopted a similar strategy in 1990 for its excise and inland customs work, but one that goes further: in addition to moving away from routine physical inspections at licensees' premises, it focusses on examining and auditing licensees' commercial systems and controls, supplemented by selective physical checks.

18.58 Revenue Canada's principal method of monitoring and enforcing compliance with the *Excise Act* and the *Excise Tax Act* is through audit and surveillance of excise licensees. Dedicated excise duty officers under the direction of regional managers in specific districts

conduct the excise duty audits and surveillances.

18.59 Exhibit 18.9 shows the number of audits and surveillances that Revenue Canada completed in 1993–94, 1994–95 and 1995–96. The 430 audits completed in 1995–96 resulted in assessments totalling \$2.7 million.

18.60 Excise duty officers have carried out numerous surveillances — 3,298 in 1994–95 and 4,508 in 1995–96. This would suggest that they are relying on the old method of maintaining a close presence on the premises of the licensees. Revenue Canada needs to monitor the surveillance activity to determine why it is so prevalent and whether it is consistent with its planned approach to reduce the on-site presence of excise duty officers. The Department advised us that it implemented substantial changes to its surveillance programs to concentrate on those elements of greatest risk potential, and is monitoring its surveillance activity for 1996–97 to assess the effectiveness of the revised surveillance program.

18.61 The Department could not tell from its records how much time these surveillances represented. The units of measurement of surveillances are not standard or consistently applied across Canada and thus do not give a good indication of work completed. If the number of surveillances is to be used to measure work done, as implied in the Department's draft monitoring plan and time measurement system, each surveillance should be appropriately weighted according to the relative amount of time or effort required to complete it.

18.62 Guidelines from headquarters on excise duty audit coverage state that distilleries, breweries, tobacco manufacturers and bonded manufacturers are to be audited on a two-year cycle, when there is a good compliance history

Revenue Canada's principal method of monitoring and enforcing compliance with excise legislation is through audit and surveillance of excise licensees.

Audit activity is concentrated on GST accounts; few excise tax audits have been done since the GST was introduced in 1991.

supported by a comprehensive surveillance program. New licensees and those considered a high risk are to be visited quarterly where feasible, until they can be placed in the cyclical audit and surveillance program. But the Department does not maintain compliance profiles of excise duty licensees to help in targeting audits and determining audit frequency.

Few excise tax audits conducted since 1991

18.63 The regional Verification, Enforcement and Compliance Research audit groups perform GST and excise tax audits. The Verification, Enforcement and Compliance Research Branch in Ottawa provides functional guidance to the regions on audit strategy and allocation of audit resources.

18.64 No separate guidance is provided for excise tax audits and there is no

specific audit plan for them. They are conducted under the umbrella of the GST audit program.

18.65 Revenue Canada's stated audit strategy is to select accounts with the highest potential for revenue recovery per person-day. Excise tax audits of excise licensees are rated low in potential for revenue recovery, particularly when compared with GST audits, which are performed by the same auditors. Audit activity is therefore concentrated on GST accounts; few excise tax audits of excise licensees have been done since the introduction of the GST in 1991.

18.66 The Department does not produce, on a regular basis, reports providing information on the number of excise tax audits completed and assessments made, and so does not know how many excise tax audits have been completed during the past five years. In

Exhibit 18.9

Excise Duty Audits and Surveillances Planned and Completed, with Assessments, 1993-94 to 1995-96

Commodity and Type of Audit	1994-95	1993-94			1994-95			1995-96		
	Number of Licensees	Planned	Completed	Assessed (\$ millions)	Planned	Completed	Assessed (\$ millions)	Planned	Completed	Assessed (\$ millions)
Beer	269									
Audit		81	37	N/A	60	59	N/A	N/A	84	1.5
Surveillance		2,086	1,585	N/A	1,864	1,177	N/A	N/A	1,861	1.1
Spirits	98									
Audit		301	155	N/A	280	142	N/A	N/A	292	0.3
Surveillance		2,336	1,657	N/A	2,317	2,078	N/A	N/A	2,121	5.6
Tobacco	92									
Audit		51	64	N/A	38	34	N/A	N/A	54	0.9
Surveillance		315	40	N/A	142	43	N/A	N/A	526	(0.3)
Total Licensees	459									
Total Audits		433	256	N/A	378	235	N/A	N/A	430	2.7
Total Surveillances		4,737	3,282	N/A	4,323	3,298	N/A	N/A	4,508	6.4

N/A = Not Available

Source: Revenue Canada

July 1996, the Department provided us with an ad hoc report listing active accounts with audits for 1994–95. Our analysis of the report shows that the Department conducted audits of 39 excise licensees, but no indication is given of the type of audit — excise tax, GST, or federal sales tax. No excise tax audits have been done on most large licensees in the past five years, including tobacco manufacturers and all oil companies but one. We were advised that excise tax audits of large oil companies in the past generally yielded millions of dollars in audit assessments. Because audits are statute-barred after four years, we are particularly concerned that in not auditing them, the Department risks failing to collect significant amounts of revenue. It is critical that the Department maintain a sufficient audit presence to effect deterrence.

18.67 Furthermore, Revenue Canada advised us that it relies on post-audit of vendors of motive fuels to assess any risk to revenue or any abuse of the exempt provisions. Since the Department has audited only one of the big oil companies in the past five years, it has not assessed the extent of abuse or the risk to revenue.

18.68 Although some of the additional resources provided to Revenue Canada for the anti-smuggling initiative were allocated for additional GST/excise audits (see paragraph 18.24), the Department has done very few excise tax audits.

No formal risk analysis to help target audits

18.69 Departmental staff advised us that the scope and depth of an excise duty or excise tax audit are determined by the licensee's compliance history as well as its controls and accounting system. However, no formal risk analysis is performed to

help determine the nature, extent and timing of selection of licensees for audit. Neither compliance profiles of licensees nor the results of excise audits, including the types of errors and the amounts that were assessed, are summarized and analyzed to assess risk and to target future audits. In addition, few audits of licensees' controls and accounting systems have been completed.

18.70 We are concerned that without compliance profiles and any formal risk analysis, Revenue Canada may be excluding from its audit selection those licensees with higher risks of non-compliance.

Audit programs require formal updating

18.71 Standard excise duty audit programs are designed for each industry to ensure that audits are consistent, fair and equitable to all licensees audited. The current audit programs were prepared at least 20 years ago and updated in 1989. However, they still include many steps and procedures that are redundant. Some regional audit staff have made informal changes to these audit programs to meet previous or revised audit objectives, and to reflect technological changes in current production and business practices of licensees. These revisions are not standard across Canada, and have not been formally approved by the Excise Duties and Taxes Directorate at headquarters.

18.72 Standard excise tax audit programs are not used in the regions. In one region, staff who did an excise tax audit in 1995 had developed their own audit program in the absence of existing audit programs.

18.73 There is a need in the regions for standard excise tax audit programs so that excise tax audits of some of the major licensees and others with higher

The Department has done an excise audit of only one of the big oil companies in the past five years.

compliance risks can be readily and consistently performed.

Training needed to provide enough qualified auditors for the workload

18.74 Most of the present excise duty audit staff are former excise officers who previously performed surveillance work at licensees' premises. Key excise duty auditors have been performing the same major audits for many years and some have recently retired. Because excise duty is relatively small compared with other areas such as income tax and GST, excise duty audits are perceived by qualified audit staff as providing limited opportunities for career advancement.

18.75 Most excise tax auditors have been performing primarily GST work since 1991, and have had little recent experience in excise tax audits. Partly because of reduced involvement in excise tax audits and partly because of lack of formal training, the number of auditors with excise tax audit experience and good knowledge of particular industries, such as jewellery and motive fuels, has declined. As a result, excise tax audits of certain commodity sectors have been neglected.

18.76 No formal excise duty or excise tax audit training has taken place for over five years. Nor has special training been provided to address changes in technology and business practices, including relevant computer training, which is essential in today's audit environment. The updating of the excise duty training materials and the offering of formal training have, until recently, been put on hold pending the completion of the ongoing *Excise Act* review.

18.77 As part of the Department's administrative consolidation process, the excise audit group has been joined by staff with and without previous excise audit

experience, making the need for training urgent.

18.78 We are concerned about the loss of corporate memory, in both excise tax and excise duty audit teams, that has already taken place and that will continue when others retire. Departmental officials advised us that the Excise Taxes and Special Levies Division of the Excise Duties and Taxes Directorate has developed an updated general excise tax course, and that it would be ready for release to the field in the summer of 1996. However, no dates have been set to offer this course.

18.79 Revenue Canada should:

- **monitor its excise duty surveillance practices to ensure that they are consistent with its strategy for administering excise duties;**
- **reinstate appropriate excise tax audit coverage;**
- **use risk analyses in selecting excise duty and excise tax licensees for audit;**
- **update and standardize all excise duty and excise tax audit programs to reflect technological changes in licensees' methods of doing business and to foster consistency and fairness in their application to all licensees; and**
- **address the staffing and training required as a result of the changed demands of excise audit work.**

Revenue Canada's response: Prior to 1995–96, Revenue Canada implemented substantial changes to its excise duty surveillance program to concentrate on those elements of greatest risk potential, revenue protection and the tracking of dutiable goods. The Department is currently assessing the effectiveness of the revised surveillance program to determine whether its excise duty surveillance practices in fact reflect its strategy for the administration of excise duties.

Most excise tax auditors have had little recent experience in excise tax audits.

We are concerned about the loss of corporate memory in excise audit teams that has already occurred and that will continue as more experienced auditors retire.

Eighty to ninety percent of excise tax revenues are collected from large business licensees. These licensees are now a component of the Large Audit Program and will be audited every second year. These audits will cover the full two-year period since the previous audit. In addition, when a file is selected for GST purposes and the registrant is also an excise tax licensee, a concurrent excise tax audit will be conducted.

The Compliance Review Program is designed to expand audit coverage by having auditors assess risk of non-compliance for GST and income tax when either tax is audited. During the course of either a GST or income tax audit, specific risk indicators of the other tax are reviewed. Similar risk indicators will be built into the Compliance Review Program to identify potential excise non-compliance issues during the course of an income tax or GST audit.

Revenue Canada will establish a standardized method of recording and analyzing risk for excise duty licensees. This will include identification of areas of licensee non-compliance, development of licensee histories, and establishment of risk assessment frameworks.

With respect to excise tax licensees, Revenue Canada has strengthened its audit approach, particularly for large licensees. These licensees, which account for 85 percent to 90 percent of the revenues collected, will be audited every second year. These audits will cover the full two-year period since the previous audit. The remaining excise tax licensee population will be subject to compliance reviews and regular audit coverage, which is consistent with departmental practice in similar situations. The Department will conduct a risk analysis of this population to determine whether this approach requires adjustment.

Revenue Canada will review and update, where necessary, its excise tax audit manual and its excise duty audit manual

to reflect current audit techniques and current technological methods of doing business. The revised manuals will be distributed to all tax services offices.

Revenue Canada has taken steps to improve the training available to auditors of excise duties and taxes.

All auditors are now given a legislative training course as well as general audit training. For auditors of excise tax licensees, a self-study course, specific to excise taxes, is being developed and will be available in the fall of 1996. In the case of excise duty auditors, a revised excise duty course has been delivered twice this fiscal year and is available on demand.

Monitoring of Compliance and Performance

Revenue Canada's monitoring needs improvement

18.80 Revenue benchmarks are lacking. Estimates of expected revenue from excise duties and taxes at a detailed level — by individual commodity, region and district — would serve as useful benchmarks for monitoring, assessing and analyzing revenue gaps, for targeting compliance efforts, and for improving revenue forecasts. Such data would also be useful to Finance in its efforts to monitor revenues from excise levies on particular commodities.

18.81 However, Revenue Canada officials advised us that it is not their role to prepare these estimates, but rather that of Finance. As noted below, Finance makes projections and monitors at a highly aggregated level whether revenues meet forecasts. However, Revenue Canada, as the administrator of excise duties and taxes, needs a basis for monitoring actual against expected revenues. It is in a better position than Finance to prepare more detailed

The Department lacks relevant information and indicators needed to assess compliance with excise duty and tax measures.

benchmark estimates for individual commodities from its administrative data.

18.82 Revenue Canada monitors and annually reports indicators of enforcement results such as total excise revenue, assessments (a proxy for revenue recovery, since not all assessments translate into revenue) and seizures. The regions report the number and dollar value of seizures to headquarters each month to assist in tracking the results of the anti-smuggling initiative. These reports focus on the operational dimensions of the Department's activities, and do not necessarily indicate the trend in the extent of the evasion problem.

18.83 However, the Department lacks relevant information and indicators for assessing compliance with the selected commodity tax measures, for monitoring its performance in administering the excise duties and taxes, for allocating resources, for providing accountability, and for assisting Finance in its monitoring and policy review. For example, it has not maintained and analyzed data to help it administer the fuel tax exemption provisions and assess the extent of

evasion, if any, through their improper use.

18.84 Exhibit 18.10 shows examples of indicators that the Department could use for monitoring performance.

Finance's monitoring could benefit by more detailed data from Revenue Canada

18.85 Finance uses a variety of data from Statistics Canada and provincial and industry sources to estimate, at a high level of aggregation, the amounts of excise revenue that Revenue Canada could be expected to collect. It monitors actual revenues against those estimates to determine whether the government is obtaining the appropriate amounts of revenue from each commodity tax.

18.86 For example, for motive fuels, Finance compares estimates derived from Statistics Canada on monthly sales volumes for gasoline, aviation gasoline, diesel fuel and turbo fuel with the actual amounts collected by Revenue Canada. Its analysis indicated only a marginal revenue loss (\$55 million out of almost \$4 billion for 1994–95).

Exhibit 18.10

Examples of Indicators for Monitoring Performance and Compliance

- Data on the volume of taxed and non-taxed sales of excisable commodities and taxes collected on each, by type of use and class of users or purchasers, to help analyze and assess the adequacy of the levels of excise duty and tax revenue from each commodity
- Actual compared with expected or estimated revenue, by commodity and by location, to help assess whether the right amount of revenue is being collected
- Compliance profiles of excise licensees, to help target the audits of licensees
- Analyses of seizure statistics by type, origin and method of evasion used by those from whom contraband goods are seized, to help assess and address the evasion problem
- Seizure statistics related to resources used in enforcement and to revenues, and analyzed to assess the results of efforts to combat evasion of commodity taxes
- Breakdown of audit assessments into initial assessments, assessments sustained and assessments actually collected
- Estimates of revenue foregone as a result of exemptions from fuel taxes, to help in monitoring compliance with the exemption provisions and assessing whether the exemptions are being abused or misused
- Annual estimates of the amounts of revenue lost through evasion, to track trends in commodity tax evasion and to assist in determining the type and level of resources and effort to be applied to address the evasion problem

18.87 However, the Statistics Canada sales figures are provided by fuel producers, and presumably are the basis for assessing their tax liability to Revenue Canada. Since the data do not come from independent sources, the comparison of Statistics Canada and Revenue Canada data provides an indication of only the quality of record keeping by Revenue Canada; it does not indicate the extent of evasion. One useful piece of information to monitor would be estimates of revenue foregone as a result of exemptions from fuel taxes. The information would also assist Revenue Canada (the administrator, who would be in a better position to obtain the information) in monitoring compliance with the exemption provisions. Analysis of diesel fuel revenue would also be useful to assess the domestic diversion of home heating fuel, for example, by looking at surveys of fuel wholesalers.

18.88 For tobacco, Finance uses data produced by Statistics Canada on the production and disposition of tobacco products. It monitors tobacco on a quarterly, semi-annual and yearly basis rather than monthly. These data track legal sales only. Finance also estimates the extent of tobacco smuggling. At the provincial and regional levels, the Department estimates smuggling levels by comparing annual data from regional tobacco consumption surveys with regional tobacco sales.

18.89 For alcohol, Finance uses both quantitative and qualitative indicators and analyses for monitoring excise duty on distilled spirits and beer. Quantitative indicators come from a variety of sources, including the annual statistical report of the Association of Canadian Distillers, and the monthly sales bulletin and annual statistical bulletin of the Brewers

Association of Canada. These data generally reflect only sales of tax-paid products. It is only by using indicators of consumption that the scope of the evasion problem becomes apparent. Qualitative information comes from regular discussions by Finance officials with both the Excise and the Customs areas of Revenue Canada, the RCMP, individual provincial liquor authorities, the Canadian Association of Liquor Jurisdictions and industry representatives.

18.90 There are no databases for Finance to track the market for contraband alcohol accurately. In the spring of 1995, as a result of earlier work that suggested a significant problem was developing with contraband alcohol, it initiated a project to track the sales of beverage alcohol. It requested all provincial liquor authorities to submit the sales volumes of beer, spirits, wine and coolers on a monthly or quarterly basis.

18.91 We have concluded that Finance's monitoring would be enhanced if Revenue Canada could provide it with more relevant and detailed information, including benchmarks and some of the other data listed in Exhibit 18.10.

18.92 Revenue Canada, in collaboration with the Department of Finance, should review and develop appropriate indicators and analytical data for monitoring compliance and performance, for supporting decision making and for providing accountability.

Revenue Canada's response: Revenue Canada agrees with the recommendation and will undertake, in collaboration with the Department of Finance, to improve the information required to monitor compliance and performance to support decision making and accountability.

Better information from Revenue Canada would help Finance determine whether the government is obtaining the appropriate revenue from each commodity tax.

Evaluation

Evaluation studies by Finance

18.93 Finance evaluated the tobacco tax in 1993 because of the smuggling problem, which made it a governmental as well as a departmental priority. Finance used the tobacco tax evaluation as a source of information during the development of the government's action plan on tobacco smuggling.

18.94 Also in 1993 an evaluation of the jewellery tax became a departmental priority because of industry pressure, and was used extensively to respond to the Canadian Jewellers Association's requests to repeal the tax. The jewellery excise tax has been evaluated (even though it yielded only \$59 million) but not motive fuel taxes, which yielded \$3.8 billion in federal excise revenue in 1994–95.

18.95 Finance officials advised us that the Department has no current plans to evaluate any commodity tax, including fuel taxes. They believe that there is no major problem with evasion of fuel taxes.

18.96 Yet Finance recognizes the possibility of evasion through the use of the tax exemption for home heating fuel. It believes that the only solution to this problem is to tax heating fuel. It has noted that the combined level of federal and provincial fuel taxes provides an incentive to evade them, and that the opportunity for evasion continues to exist. Some provinces consider evasion of fuel taxes to be a serious problem.

18.97 Finance should consider the need for a review of the fuel excise taxes, including their effects on evasion and competitiveness, in the light of potentially serious fuel tax evasion.

Finance's response: The Department of Finance is concerned about any evasion

of federal excise taxes and duties. With respect to fuel taxes, it monitors fuel tax revenues on an ongoing basis and, as noted in the chapter, compares tax collection data with Statistics Canada fuel sales data. The Department's ongoing monitoring and analysis suggest that fuel tax evasion is limited.

The structure of the federal excise taxes on fuel limits the opportunities for tax evasion. These taxes are imposed at the manufacturers' level, which is confined to a small number of taxpayers. As well, there are virtually no excise tax exemptions for gasoline and the exemptions for diesel fuel are essentially limited to heating fuel and fuel used for the generation of electricity.

While the Department is of the view that the structure of the federal excise taxes on fuel is effective in curtailing the threat of significant evasion, it will review the need for an evaluation of these taxes.

Quicker Action Needed on Legislative Review

18.98 In 1989, Revenue Canada completed an evaluation of the excise duty function. The Department's Program Evaluation Services advised us that the direct response to the findings of that evaluation was an action plan that included the current *Excise Act* review now being carried out jointly with the Department of Finance.

18.99 **Need for review.** Revenue Canada and the Department of Finance have long recognized the need to review and revise the *Excise Act*. Revenue Canada officials advised that through a combination of periodic legislative amendments (largely "quick fixes" to deal with specific problems), flexible regulatory provisions, and administrative arrangements agreed to by the Department and tax remitters, the *Excise Act* has been made to work reasonably well over time

Finance has noted that the combined level of federal and provincial fuel taxes provides an incentive to evade them, and that the opportunity for evasion continues to exist.

without a major in-depth review and overhaul.

18.100 The departments and the affected industries are concerned that many of the provisions of the *Excise Act* are outmoded and in need of reform. The overall philosophy of the Act is one of absolute control and strict adherence to a detailed and rigid set of rules to ensure that revenue to the Crown is maximized.

18.101 Finance, Revenue Canada and affected industries view some sections of the Act and Regulations to be archaic, ambiguous and unenforceable. Many of the controls are now inconsistent with modern business practices, and some controls reportedly create inefficiencies for manufacturers. Moreover, there is no formal appeals process.

18.102 Previous reviews. Both Finance and Revenue Canada have reviewed certain aspects of the *Excise Act* over the past 21 years. In 1975, Finance prepared a Discussion Paper on Federal Sales and Excise Taxation. The paper was tabled as part of the 23 June 1975 federal Budget. In 1977, a review group of officers from both Finance and Revenue Canada was asked to analyze the briefs submitted in response to the discussion paper and, where necessary, to reassess the conclusions of that paper in the light of the evidence presented in those briefs. As noted above, Revenue Canada's Audit and Evaluation Directorate completed a review of the excise duty function in 1989. In 1990, in response to that evaluation, Revenue Canada developed a three-year action plan and established an excise duty task force. One of the objectives of the task force was to undertake a comprehensive review of the *Excise Act*.

18.103 Scope and objectives of the review. Both Revenue Canada and

Finance agreed on the need for a review in 1990, covering the *Excise Act* and the provisions of the *Excise Tax Act* pertaining to alcohol and tobacco products. Not covered are the provisions of the *Excise Tax Act* related to other products such as motive fuels, which account for approximately 83 percent of total federal excise tax revenue. The review also does not question the tax rates applied to the commodities or the breadth of the tax base. Instead, it focusses on the structure of the tax.

18.104 The key objective is to have legislation that provides a fair and modern tax structure, minimizing the compliance burden on affected industries and safeguarding significant revenue from taxes on alcohol and tobacco products. The intention is to replace existing provisions with an entirely new piece of legislation governing these products.

18.105 Delays in completing the review. Although there was agreement on the need for a review, Revenue Canada and Finance officials advised us that other concerns, such as the introduction of the goods and services tax and the smuggling of tobacco products, took priority. The review began in 1993 and is still in progress. It was expected to be completed by September 1996.

18.106 Finance and Revenue Canada officials advised us that current projections call for tabling the draft legislation in early 1997, obtaining royal assent by June 1997 and implementing the new program in January 1998.

The *Excise Act* review is delaying needed improvements

18.107 Revenue Canada has a formal process for dealing with identified needs for legislative change. Since the legislative review began, most needed changes have been passed on to the

Finance, Revenue Canada and affected industries view some sections of the *Excise Act* to be archaic, ambiguous and unenforceable.

Legislative Review Group to be dealt with as part of the review. However, this approach and the protraction of the review have held up some needed changes and desired improvements in the Act and its administration. These include organizational restructuring of excise tax and excise duty programs (both programs are currently kept separate pending the completion of the review); revision of the policy and procedures manual; changes to the penalty structure proposed by the Pacific region; and updating of excise duty course material for training staff.

18.108 Revenue Canada and Finance should urgently complete the Excise Act review.

Departments' response: Both Revenue Canada and the Department of Finance recognize the urgent need to complete the Excise Act Review.

Extensive consultations have taken place with interested industries and provincial liquor boards, and policy alternatives have been thoroughly analyzed. Development of proposals for a new structure for the taxation of alcohol and tobacco is close to completion.



About the Audit

Objectives

Our audit objective was to examine Revenue Canada's administration of the *Excise Act* and the *Excise Tax Act* as they apply to the selected commodities, with a view to:

- determining whether its controls, procedures, systems and practices are sufficient to ensure that all items liable to tax are identified, and that the appropriate excise duties and taxes are properly assessed, collected and reported; and
- providing objective information to help Parliament scrutinize the administration of the selected commodity tax measures.

We audited Finance with a view to:

- examining how the Department monitors, evaluates and reports on the selected commodity tax measures; and
- providing objective information to help Parliament scrutinize the results of the tax measures.

Scope

Our audit was directed at Revenue Canada and Finance. It did not include the RCMP, which is also involved in enforcing these Acts. Rather, we looked at how Revenue Canada co-ordinates its enforcement efforts with the RCMP. Also, although the *Excise Act* is both a taxing and a regulatory statute, our audit focussed only on the tax revenue dimension of the Act.

In Revenue Canada we examined the following issues: combatting evasion, monitoring compliance and performance; evaluation and legislative review; and audits of excise licensees.

In Finance we examined two issues: monitoring, and evaluation and legislative review.

Criteria

We would expect Revenue Canada to:

- have a systematic process and a co-ordinated approach to identify, track and combat evasion of excise and customs duties and excise taxes, and to monitor the results of its efforts to combat such evasion;
- systematically monitor compliance with the requirements of the law applicable to the production, sales, bonded warehousing, export and import of the selected (and other) commodities; and information on the results and other operational performance of its administration of the relevant commodity tax measures; and
- perform sufficient, appropriate and timely audits so as to establish the accuracy of the licensee-reported figures used to calculate the amounts due for excise duty and excise tax.

We would expect Finance to regularly monitor and report the results and other performance indicators of the tax measures.

We would expect the Department of Finance and Revenue Canada to evaluate the commodity tax measures periodically to assess their effectiveness and the continued relevance of the legislation, as well as the efficiency of its administration.

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Chapter 19

Revenue Canada

Child Tax Benefit and Goods and
Services Tax Credit Programs

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Revenue Canada

Child Tax Benefit and Goods and Services Tax Credit Programs

Main Points

19.1 Revenue Canada administers two key social programs: the Goods and Services Tax Credit and the Child Tax Benefit programs. Both are delivered through the tax system. Prior to September 1995, Revenue Canada administered child tax benefits jointly with Human Resources Development Canada (HRDC). The latter was responsible for determining basic eligibility and Revenue Canada was responsible for all other aspects of the program.

19.2 Each year under these programs about \$8 billion in benefits flows tax-free to over 8 million recipients. Most are families with low or modest incomes.

19.3 Revenue Canada faced a significant challenge to launch the GST credit on time in 1990 and the child tax benefit in 1993, given the short lead times available to meet statutory deadlines. For child tax benefits, the challenge was shared with HRDC. Notwithstanding some important weaknesses in the initial systems, we were impressed with the ability of both departments to publicize the programs and meet the statutory deadlines. Since the programs were launched, millions of families and individuals have been receiving monthly or quarterly social benefit payments. To date, over \$30 billion has been paid out under these programs.

19.4 Revenue Canada has been working to improve service and reduce costs by streamlining its administrative processes. Despite some successes, we have four concerns about the administration of these programs. First, we found that service needs to be substantially improved in some key aspects of delivering the programs, namely in providing access to the Department by phone and in processing child tax benefit applications. Second, the control environment needs to be significantly strengthened to provide reasonable assurance that only those who are eligible receive benefits and receive them in the correct amounts. (This was also the case with HRDC while it had responsibility for determining basic eligibility for child tax benefits, until August 1995.) Third, Revenue Canada has not developed a formal strategy for detecting and preventing fraud and abuse in the programs. Fourth, the Department does not monitor the programs to assess whether the total amount of benefits flowing from each program is reasonable in the aggregate, considering changes in population characteristics and family structure. Our analysis of program statistics against independent data on key variables suggests potentially serious problems that require immediate attention.

19.5 The Department of Finance is responsible for assessing the extent to which program policy is producing the desired outcomes. Despite their social significance and the dollars involved, neither program's performance has been evaluated against its stated objectives. Further, neither program is scheduled for evaluation in Finance's current three-year plan.

19.6 Although child tax benefits and GST credits are key components of Revenue Canada's income redistribution line of business, Parliament receives little information on the Department's performance and priorities in administering the two programs. The little information that is reported in the Department's Part III of the Estimates needs to be strengthened and improved.

Introduction

New programs represent an \$8 billion annual share of Canada's social safety net

19.7 This audit examines two key social transfer programs administered through the tax system: the Goods and Services Tax Credit, introduced in 1990, and the Child Tax Benefit, introduced in 1993. As shown in Exhibit 19.1, expenditures under both are substantial: currently, about \$8 billion per year in combined benefits flows tax-free to well over 8 million families and individuals, primarily those with low and modest incomes.

19.8 The two programs were introduced for different purposes. The GST credit was instituted to help families and individuals with low or modest incomes offset all or part of the GST that they pay. The child tax benefit was introduced to replace the former patchwork of child benefits delivered through the Family Allowance, Child Tax Credit and Dependant Tax Credit programs. Its objectives were to help families meet the cost of raising children and to be more responsive to the needs of families with low and moderate incomes by providing a unified child benefit that would be simpler, fairer and more generous to such families. Although the two programs have distinct objectives, both provide a cash supplement to families that increases with family size and diminishes when family income rises above a given threshold.

19.9 Until August 1995, Human Resources Development Canada (HRDC) and Revenue Canada jointly managed the child tax benefit but had distinct roles. Basic eligibility for benefits was determined by HRDC, and Revenue Canada was responsible for all other

aspects of the program — primarily establishing how much individual recipients were entitled to receive, issuing benefit payments, maintaining participant benefit records (benefit rolls) and handling all telephone enquiries. On 28 August 1995, Revenue Canada assumed full responsibility for administering the child tax benefit, including determining basic eligibility for benefits. In the case of the GST credit, Revenue Canada has been responsible for all aspects of administration since the program's inception.

19.10 The Department of Finance is responsible for setting fiscal policy and evaluating the extent to which the two programs are producing the desired outcomes. Human Resources Development Canada continues to be responsible for social policy in general, which includes promoting and strengthening the income security of families with children. Changes in social policy could therefore have implications for future child tax benefits.

19.11 For a number of reasons, both of these programs warrant Parliament's interest. First, they represent a significant share of total federal direct social transfers to Canadians, particularly low- and modest-income families with children. Second, they represent a substantial shift

Expenditures under both programs are substantial: currently, about \$8 billion per year in combined benefits flows tax-free to well over 8 million families, primarily those with low and modest incomes.

Exhibit 19.1

Key Comparisons between the Child Tax Benefit and GST Credit Programs

	1994-95 Benefit Year	
	Child Tax Benefit	GST Credit
Estimated number of recipients	3.4 million	8.3 million
Amount paid	\$5.3 billion	\$2.8 billion
Average payment per family	\$1,563	\$342
Number of payments issued per year	36.6 million	33.4 million

Source: Unaudited departmental records

Unlike the majority of the Department's programs, these are not revenue programs but expenditure programs and hence present additional challenges and aspects of accountability for Revenue Canada.

in the way the federal government provides cash transfers to individuals. They rely on the tax system and its associated administrative machinery to assess program eligibility, determine entitlements and deliver periodic benefits to families. Third, unlike the majority of the Department's programs, these are not revenue programs but expenditure programs and hence present additional challenges and aspects of accountability for Revenue Canada.

Over \$30 billion tax-free paid to date

19.12 Since the child tax benefit and GST credit were first instituted, over \$30 billion has been paid out to date to supplement low and modest family incomes. For the 1994–95 benefit year, departmental records show \$5.3 billion paid in child tax benefits and \$2.8 billion paid in GST credits. In the past three years, total payments of child tax benefits have remained relatively stable. In contrast, payments of GST credits have shown an upward trend, from \$2.5 billion in 1992–93 to \$2.8 billion in 1994–95. Exhibit 19.2 provides year-to-year

aggregate statistics on spending under each program for benefit years 1991–92 to 1994–95. The 1995–96 benefit year was still in progress at the time of our audit.

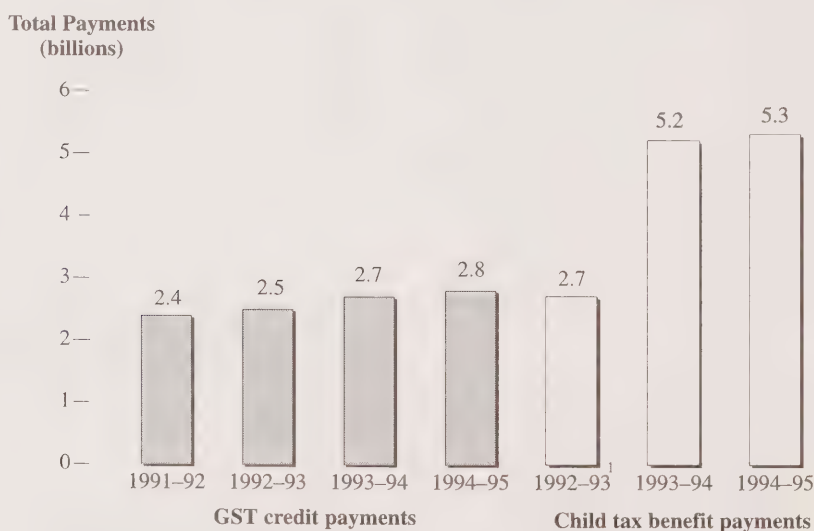
19.13 To receive benefits under either program, participants must file a tax return and, for child tax benefits, so must the married or common-law spouse. Legislation requires individuals to apply if they want to receive benefits under these programs. The application for GST credits is found in the body of the personal tax return. To receive child tax benefits, the primary caregiver must apply for each child using a separate application form. Those children who were registered as eligible under the family allowances program at the end of 1992 were automatically included.

Marital status, family income and number of dependants determine benefits

19.14 For both child tax benefits and GST credits, the key variables that determine the level of benefits received are marital status, family income, and the number and ages of dependants. The amounts a family receives will change

Exhibit 19.2

**Child Tax Benefit and GST Credit
Payments for Benefit Years 1991-92
to 1994-95**



Source: Unaudited departmental records

¹ Since child tax benefit payments began in January 1993, 1992-93 represents only a 6 month benefit period.

over time according to changes in these variables. For the 1994–95 benefit year, the average child tax benefit was about \$937 per child, translating into an average of \$1,563 per entitled family. The average quarterly payment of GST credits per entitled family was \$85, or \$342 per year. There is no maximum dollar limit on the amount a family or individual may receive under either program. The number of dependants a family has will largely influence the amount of benefits to be received. For example, for the 1994–95 benefit year, about 1,000 low-income families with many children each received more than \$10,000 in child tax benefits. Exhibits 19.3(a) and 19.3(b) provide more detailed information on the range of child tax benefits and GST credits paid in the 1994–95 benefit year and on who received them.

19.15 An important feature of both programs is that the benefits, which are tax-free, are based on net income of the family, not of individuals. Family net income is the combined net income for tax purposes of the recipient and his or her married or common-law spouse. This

measure of family income is important for both programs, as benefits are “targeted” to provide maximum assistance to families with net incomes of \$25,921 or less. Benefits decrease when family net income exceeds this threshold. Both types of benefit may include an additional supplement. For the child tax benefit, the supplement is meant to reinforce incentives for low-income families to participate in the work force and to offset some of the expenses associated with holding a job; the maximum additional supplement for a family is \$500 per year, expected to increase to \$750 in 1997–98 and \$1,000 thereafter. For GST credits, the supplement reaches a maximum of \$105 per year, and is available only to single adults with low incomes. It is meant to recognize the extra costs that most single people incur, such as maintaining a household on their own.

19.16 Both programs follow a July-to-June benefit year. Each July, Revenue Canada recomputes the amount a family is to receive in child tax benefits during the new benefit year. The amount is based on the prior year’s family income

There is no maximum dollar amount a family or individual may receive under either program. The number of dependants a family has will largely influence the amount of benefits to be received.

Net Family Income Class	Average Number of Children per Month*	Total Number of Families in Year	Net Benefits Paid (\$000)
Under \$25,921	3,049,100	1,623,860	3,486,436
25,921 to 30,000	250,040	176,750	264,781
30,000 to 40,000	620,140	425,810	572,884
40,000 to 50,000	597,760	400,450	438,316
50,000 to 60,000	525,540	351,910	287,111
60,000 to 70,000	345,470	247,920	141,956
70,000 to 80,000	138,680	96,710	55,909
80,000 to 90,000	61,330	32,690	22,099
90,000 to 100,000	29,190	14,640	9,173
100,000 and over	23,170	11,630	8,315
TOTAL	5,640,420	3,382,370	5,286,980

Exhibit 19.3(a)

Average Number of Children and Total Number of Families Receiving Child Tax Benefits, July 1994 to June 1995 Benefit Year

Almost half of recipients of child tax benefits have family incomes of less than \$ 25,921 per year.

* The average number of children per month is lower than the total number of children who received benefits at any one time during the year.

Source: Unaudited departmental statistics and Office of the Auditor General tabulations

The person primarily responsible for caring for and raising a child receives the child tax benefit payment. Any resident of Canada who is 19 years of age or older or who is a parent can apply for the GST credit.

as assessed through the tax system and on the current family structure. For GST credits, benefits are computed according to the family income and family structure that existed on December 31 of the previous year.

19.17 The person primarily responsible for caring for and raising a child — usually the mother — receives the child tax benefit payment. However, the father or a grandparent or guardian could receive it instead. Benefits continue from the birth of a child until he or she turns 18, depending on family income levels and changes in family structure. For the GST credit, any resident of Canada who is 19 years of age or older (married or single) or who is a parent can apply. Recipients of GST credits must apply each year and indicate the number of dependants they have in order to continue receiving benefits.

19.18 With both child tax benefits and GST credits, the law provides for increases to basic benefits when inflation exceeds three percent. To date, this has not happened. As well, in the case of child tax benefits, provinces can modify the benefit structure within specified limits to better suit their needs. Both Quebec and Alberta have done so.

Focus of our audit

19.19 Our audit examined Revenue Canada's and HRDC's joint administration of child tax benefits and Revenue Canada's administration of GST credits — among other things, how the departments have ensured that all those entitled to benefits receive them, and what measures both have taken to protect the Crown from unnecessary losses. We carried out our audit work at Revenue Canada's headquarters and in several regional offices, tax centres and tax services offices across Canada. We also interviewed officials at HRDC and the Department of Finance to learn about their respective roles and to assess their related practices in administering and evaluating child tax benefits and/or GST credits.

19.20 Our overall approach was to focus on key aspects of program administration for both GST credits and child tax benefits. In the latter case, the transition from joint administration to the transfer in August 1995 of responsibility for program delivery to a single department necessitated that we look at the program's administration from the global perspective of the federal government; we note that child tax benefits have been in place since January 1993. Further details on our audit objectives, approach and criteria are presented at the end of the chapter, in **About the Audit**.

Exhibit 19.3(b)

GST Credit Payments by Net Family Income

The majority of recipients of GST credits have family incomes of less than \$25,000 per year.

Net Family Income	Total for July 1994 to June 1995 Benefit Year	
	Number of Recipients	Net Benefits Paid (\$000)
Loss and Nil	153,370	45,278
\$1 to 5,000	768,400	194,785
5,000 to 10,000	1,565,100	433,931
10,000 to 15,000	1,971,280	730,675
15,000 to 20,000	1,327,230	538,685
20,000 to 25,000	1,162,450	476,279
25,000 to 30,000	986,300	332,462
30,000 to 35,000	328,510	81,964
35,000 and over	57,220	10,401
Total	8,319,860	2,844,460

Source: Unaudited departmental records and Office of the Auditor General tabulations

Observations and Recommendations

Facilitation

19.21 The term facilitation refers to the mechanisms for ensuring that all eligible people in Canada know that child tax benefits and GST credits are available to them. It also refers to the mechanisms for enabling people to apply for and, ultimately, to receive their benefits. In reviewing facilitation we looked at the launches of both programs and at subsequent program activities.

The launches of both programs were well managed

19.22 Revenue Canada had an extremely short time to design and implement the procedures and systems associated with the GST Credit and Child Tax Benefit programs. The Department had only 20 months from the Budget announcement of the goods and services tax in the spring of 1989 until it had to be “up and running” with mechanisms for making the first GST credit payments in December 1990. Working together with HRDC, it had an even shorter time — less than a year — to implement the systems that deliver the Child Tax Benefit Program.

19.23 The systems required to support both programs are complex. First, they must be able to deal with a huge volume of eligibility and payment transactions (about 70 million payments per year). Second, the processing itself is based on elaborate entitlement formulas in an environment where the status of recipients is subject to change, and where cross-matching an individual’s taxpayer records with those of other family members is crucial. Coupled with the demands of those systems was the need

for new systems and practices to establish eligibility criteria and, for child tax benefits, to identify a child’s primary caregiver — a first in federal child assistance. Strategies were needed to publicize the programs and to inform Canadians about how to apply for and receive the new benefits. Finally, the systems also had to be able to respond to enquiries, complaints and requests from millions of Canadians.

19.24 We were impressed with Revenue Canada’s and HRDC’s separate and joint ability to respond to the challenge of launching the programs successfully in the short lead times available to meet statutory deadlines. Moreover, since the launches, these systems have formed the basis of delivery mechanisms that provide millions of Canadians with their monthly or quarterly benefits.

19.25 In the early months following the launch of each program, however, some important systemic problems did arise. For example, before child tax benefits were implemented in 1993, it was recognized that there would be problems in determining family income to compute benefits, because of the need to rely on individuals’ tax returns of the previous year for family status and related information thought to be potentially incomplete and inaccurate. Revenue Canada states that all departments involved in the launch (the Department, HRDC and the Department of Finance) agreed that this was a risk that had to be taken in order to implement the program by the legislated deadline. Thousands of child tax benefit cheques were paid out improperly during the first several months of the program. In response to the problem, recipients were asked to notify Revenue Canada if family status had been determined incorrectly. Individuals who had received benefits to which they were

We were impressed with Revenue Canada’s and Human Resources Development Canada’s separate and joint ability to respond to the challenge of launching the programs successfully in the short lead times available to meet statutory deadlines.

not entitled (many for six months or more) were asked to pay them back. (See paragraph 19.92 on processing benefits with missing or inconsistent information and paragraphs 19.114 and 19.115 on monitoring overpayments.)

Actions are under way to assess the needs of clientele

19.26 Several years into the operation of the programs, Revenue Canada continues to provide information to potential eligible recipients as well as those who are already receiving benefits. In the case of child tax benefits, it shared this responsibility with HRDC until it assumed full responsibility for that program in August 1995. However, it has been solely responsible for telephone enquiries since October 1993, including handling calls concerning basic eligibility. Since August 1995, Revenue Canada has continued HRDC's practice of distributing application kits for child tax benefits to hospitals across Canada so that most families with new children can apply soon after the birth of a child; the kits are also available in tax services offices and some immigration offices. Revenue Canada has also modified the kits in an effort to better meet client needs.

19.27 In disseminating information about both child tax benefits and GST credits, Revenue Canada generally uses most of the same channels of communication it uses for its revenue-related lines of business. For example, the Department issues monthly or quarterly press releases as benefit payments are issued and provides separate toll-free 1-800 service lines for each program. As well, notices of determination are sent each new benefit year to all program participants, informing them of the benefits they will be receiving in the upcoming year. The Department

also includes information on GST credits and child tax benefits in its various income tax returns, guides and pamphlets. Some of the publications target specific groups and include summary information about the programs, geared to answer some basic questions for the intended audience. Others, such as the tax returns, are more general in nature. Yet, as suggested in a 1993 departmental study on client enquiries, publications may not be the best vehicle for meeting the information needs of program clients. The study indicated that over 40 percent of GST credit and child tax benefit recipients surveyed who had contacted the Department about the programs were not aware of the existence of program publications that might have satisfied some information needs. Of those who were aware of the publications, over 40 percent were either not using them or had trouble understanding them.

19.28 To ensure a general level of awareness about the programs, the Department believes that providing information on the programs in tax return packages is an effective way to reach most Canadians. It has informed us that for the 1993 tax year, for example, almost 95 percent of all Canadian residents between the ages of 20 and 54, and 91 percent of older Canadians, filed returns and therefore are believed to have had at least some access to information about the programs. The Department has also been working to streamline and simplify the design of the tax packages to facilitate their use by a broad range of filers who have unique needs. For example, it has simplified return packages for lower-income seniors who file primarily for GST and provincial credits, for dependant spouses who file only for child tax benefits or other credits, and for Aboriginal people who have exempt income for benefit determinations. The

In disseminating information about both child tax benefits and GST credits, Revenue Canada generally uses most of the same channels of communication it uses for its revenue-related lines of business.

Department has incorporated the annual application for GST credits on the personal tax return, making it simpler for many Canadians to continue qualifying for them.

19.29 Beyond the tax return packages and other publications, some regionally led initiatives are also under way to get more information on Revenue Canada services to a few local groups that serve people who, because of language and other barriers, may be less aware of the programs. One local office is also pursuing preliminary discussions with a provincial welfare agency to explore opportunities for sharing information on the programs and the potential for using common delivery networks.

19.30 Despite these activities, we are concerned that most of the efforts at communication to date, although useful, may not be sufficiently responsive to the needs of most eligible program participants. During our examination, program officers consistently indicated that the programs serve a clientele that differs markedly from those of Revenue Canada's other lines of business. For example, we were told repeatedly that clients of the two programs are heavy phone users who have many questions and often require a great deal of reassurance about their benefits, but who have major problems in contacting the Department by phone.

19.31 During our audit, we wanted to obtain specific information on the profiles of current participants in both programs, and on their specific information needs. We found that Revenue Canada did not have this kind of information available. We also found that it had not tested nation-wide the level of awareness about the programs, either in major centres or in remote communities, as a means of measuring the success of its overall

approach to communication and program delivery. In the absence of this kind of information, we believe there is an added risk that the programs may be missing potential recipients, especially those who may be most in need of assistance.

19.32 Subsequent to our audit, Revenue Canada informed us that it had engaged outside consultants for a preliminary survey of GST credit and child tax benefit recipients who call the Department, to profile benefit recipient callers as well as to evaluate the effectiveness of the information they receive from other sources and to identify areas of communication that could be improved. A draft report was being considered by management.

19.33 **Revenue Canada should review the current communication strategy for child tax benefits and GST credits, evaluate whether it is meeting the information needs of eligible and existing program participants and institute measures as required to ensure that communications are appropriate to support effective program delivery.**

Department's response: Since the inception of the Child Tax Benefit and GST Credit programs, the Department has adopted effective communication strategies to address client needs. As the programs evolve, these strategies will continue to be evaluated and modified as appropriate.

Take-up rates are unknown

19.34 The "take-up rate" is a statistic that is meant to represent the proportion of all individuals for whom benefits are intended under a particular program who actually receive the benefits. In the case of child tax benefits, this would be the entitled children for whom benefits are paid, expressed as a percentage of all entitled children. In the case of GST credits, it would be the proportion of all

During our examination, program officers consistently indicated that the programs serve a clientele that differs markedly from those of Revenue Canada's other lines of business.

The Department's inactivity to date in the area of determining take-up for either program, together with that of Human Resources Development Canada for child tax benefits, is worrisome from the standpoint of both facilitation and enforcement.

entitled individuals, spouses and children for whom benefits are paid. Because these are targeted programs, some individuals who otherwise meet the eligibility requirements may not be entitled to receive benefits because their family income exceeds the threshold for qualifying.

19.35 Program take-up provides decision makers with an independent measure of a program's success in reaching those who have been targeted for benefits. Further, as paragraph 19.86 elaborates, the take-up rate is also important for gauging the extent to which people are receiving benefits to which they are not entitled. Taken together with information on program enrolments, it provides an independent benchmark against which to measure the level of "leakage" or abuse in a program.

19.36 We found that neither Revenue Canada nor HRDC has measured the take-up rate for child tax benefits and/or GST credits. While it has not defined targets for take-up as indicators of program effectiveness, Revenue Canada has informed us that its implied target for take-up is 100 percent of all entitled participants except those who have chosen to opt out of the program. Its plans for the future include determining a method to measure the extent to which all truly eligible people are (or are not) receiving the benefits to which they are entitled.

19.37 The Department's inactivity to date in the area of determining take-up for either program, together with that of HRDC for child tax benefits, is worrisome from the standpoint of both facilitation and enforcement: these two benefit programs are among the largest at the federal level that make social transfer payments to families and individuals. They involve large expenditures, and target benefits primarily to those who are

most in need. In an environment where individuals must complete applications and file tax returns before receiving benefits, and where controls over the processing of benefits are weak (see paragraph 19.78), in our opinion there could be a significant risk either that coverage of eligible participants is piecemeal or that families and individuals receive benefits for which they are not eligible and/or entitled.

19.38 The American experience with its Earned Income Credit Program, which has some similarities to our Child Tax Benefit Program, illustrates that take-up can be problematic even in a mature program that is widely publicized. Although the earned income credit has been in existence far longer than our child tax benefit, researchers in the U.S. have estimated that somewhere between only 75 and 86 percent of all entitled families actually received the credit for tax year 1990. This is an estimate of the true take-up rate, not inflated by ineligible participants.

19.39 There are some important differences in scope and practices between the earned income credit and the child tax benefit that have implications for program take-up. For example, the risk that benefits in Canada miss as many entitled families as those in the U.S. is reduced somewhat, because families who were receiving the universal family allowance were automatically included in the new program. However, children born since family allowance ended in December 1992 are not automatically included; consequently, fewer families may be participating than are eligible. Nonetheless, as paragraph 19.84 discusses, we expect that take-up for child tax benefits is higher than that experienced for earned income credits in the U.S.

19.40 We did some analysis focussing on the population of children born after the family allowance program ended in

1992. In paragraphs 19.81 to 19.88, we describe how different assumptions of the true take-up rate by families for children born after 1992 can lead to significantly different conclusions about levels of abuse or other non-compliance in the Child Tax Benefit Program.

19.41 We were unable to do a similar analysis for GST credits: there is insufficient detail in departmental records, and suitable third-party information is not available to make an analysis possible. We therefore cannot comment on the reasonableness of the level of program participation and/or quantify the extent of potential leakage in program delivery.

19.42 For both child tax benefits and GST credits, Revenue Canada should develop a methodology for determining actual program take-up rates and institute procedures for measuring and reporting periodically thereon.

Department's response: This is addressed in the Department's action plan. (See Special Insert on page 19–42.)

Families may not be aware of their legal obligation to report changes

19.43 We believe the Department could do more to inform families registered for child tax benefits of their legal obligation to report any changes in their status that could affect their benefits. Our concern is that once a child has been registered for coverage, benefits flowing to the primary caregiver of record could continue automatically until the child turns 18, even if he or she ceases to qualify for benefits. Child tax benefit recipients have an obligation to notify the Department if, for example, their marital status changes, they cease to be the child's primary caregiver, they no longer live with the child, the child no longer resides in Canada or the child dies. Revenue Canada relies generally on recipients to inform it

of any such changes, although the extent to which they know about these reporting obligations is questionable.

19.44 Recipients' reporting obligations are listed on the child tax benefit application form. However, primary caregivers complete the form only once in an 18-year period for a particular child. There are also children for whom no application was required — those who were included in the Child Tax Benefit Program from family allowances. Currently, they represent the majority of children on the child tax benefit roll. Since they did not have to complete an application form, there is a possibility that families with older children may be unaware of their reporting responsibilities. We also observed that even the monthly benefit payments do not clearly note recipients' reporting obligations. Although the notice that accompanies the monthly child tax benefit does contain a reminder on the back, it does not mention that there are penalties for failure to report changes.

19.45 In our review of practices of other jurisdictions administering broadly similar programs, we found that they place considerable emphasis on communicating recipients' responsibilities to report changes that could have an impact on entitlements. Formal processes have been established in these jurisdictions to collect this information. For example, the processes require recipients to confirm their eligibility annually in writing or to confirm at least biennially their understanding of reporting obligations that affect eligibility. By way of contrast, there is no such established mechanism for reporting changes in eligibility for child tax benefits. In our opinion, the potential financial consequences may be serious. The Department indicates that recipients may use the general 1–800 number for child

Revenue Canada relies generally on recipients to inform it of changes in their status that could affect their benefits, although the extent to which they know about this obligation is questionable.

We found that the Department's performance in processing child tax benefit applications and answering telephone enquiries about both programs could be significantly improved.

tax benefits to communicate changes in family status and structure that may affect their eligibility and entitlements. Assuming that those who are aware of their obligations to report changes would want to do so by phone, we note in paragraph 19.57 that their ability to reach the Department could prove difficult. As a result, even these groups of individuals may not report some changes.

19.46 In our view, considerable opportunity exists both to state more clearly and explicitly recipients' obligation to report changes in their status that will affect their benefits and to determine that recipients are aware of their obligations and report changes as required.

19.47 Revenue Canada should take measures to ensure that recipients' obligations to report changes in status affecting child tax benefits are clearly understood and that recipients are provided with appropriate vehicles for reporting such changes.

Department's response: Recipients' reporting obligations will be included in the Department's ongoing review of communications requirements.

Standards of service have yet to be defined

19.48 Perhaps the most important service of Revenue Canada to program clients is the regular delivery of social benefits to participants in the Child Tax Benefit and the GST Credit programs. Since the programs were first instituted, millions of Canadians on the benefit rolls have been receiving their monthly or quarterly payments, amounting to date to more than \$30 billion in benefits paid to over 8 million families and individuals.

19.49 In keeping with the federal government's Service Standards Initiative,

Revenue Canada has made commitments to develop service standards for its lines of business. However, none have yet been established for the GST Credit and Child Tax Benefit programs. In the case of child tax benefits, the Department has indicated that it would have been inappropriate to establish standards for processing applications, given that it has implemented new systems to capture eligibility information in the short period following the assumption of this responsibility from HRDC. However, we note that Revenue Canada has had complete responsibility for telephone enquiries about child tax benefits since October 1993 and, at the conclusion of our audit, there were still no formal standards of service in place.

19.50 We decided to review the Department's performance in two key areas of service to clients. We looked at application processing for child tax benefits and at telephone enquiries about both programs. Both activities deal with high volumes and are highly visible to the public. (Standards for processing GST credit applications are less critical since this is done in conjunction with the T1 returns, and typically the first payment is not made until July.)

19.51 The results of our review were disappointing. We found that performance in these two key service areas could be significantly improved.

Backlogs in unprocessed child tax benefit applications have added to delays

19.52 A key part of facilitation is ensuring that the Department processes applications and issues payments without undue delay. Each year several hundred thousand applications for child tax benefits are received for processing. We were interested in the total time it takes to process an application, but learned that the

Department's systems are not set up to produce this kind of information on an aggregate basis. Program officials informed us that, on average, applicants can expect to wait two to three months from the time the Department receives the application until they receive a cheque. A contributing factor is that the systems used to generate the monthly child tax benefit will not reflect any new transactions made within about three weeks before the date when cheques are issued. Program officials have indicated that some of this time after the "cut-off", approximately six working days, is required by Public Works and Government Services Canada to print and distribute cheques.

19.53 The time it takes to process an application can be longer than the expected average of two to three months. For example, we noted that after the transfer of eligibility determination to Revenue Canada in August 1995, the volume of unprocessed applications reached a high of 70,000 by November 1995. This backlog caused some clients to wait up to four months before receiving their first benefit cheque. The Department states that factors contributing to the backlog included the transfer of an inventory of 19,000 unprocessed applications from HRDC, and a steeper-than-anticipated learning curve among new staff who had to learn and operate both the HRDC and Revenue Canada systems for processing applications. A similar situation of backlog developed after the Department introduced a new system in 1996 for processing child tax benefit applications. The Department has since managed to process the original backlog and to reduce the new backlog by deploying supplementary resources and taking other actions as appropriate. In our opinion, however, some of these backlogs could have been avoided by more effective

up-front planning of requirements to ensure a smooth transition without affecting service to the public. Subsequent to our audit, the Department informed us that the turnaround time for processing most applications and issuing benefit cheques had been reduced to about two months.

19.54 Given that a benefit payment can represent for many a significant part of family income, we are concerned that the elapsed time before transactions are reflected in benefit cheques may still be unreasonably long and inflexible. We note that legislation allows for some flexibility in that it does not require benefit cheques to be released on a specific date in a month, as is the current administrative practice. However, benefits may not begin sooner than the month following the birth of a child. Revenue Canada does have some flexibility under the present system to issue benefit cheques manually on a priority basis when clients are in urgent need of benefits. Some 25,000 cheques were issued on this basis during the last benefit year. We are also concerned about the present lack of management information in this area of processing benefit applications, which hampers the Department's ability to ensure at least a minimum overall level of service in processing turnaround times and to pursue improvements, as appropriate, in a timely and informed way.

Access to phone lines is poor

19.55 Another key element of the facilitation process is enabling clients of either program to contact the Department by telephone. As noted, these clients make heavy use of telephone service. Program officials indicate that the clients prefer getting answers to their questions by phoning the Department rather than writing or visiting a Revenue Canada office in person, and that many require

The present lack of management information for processing child tax benefit applications hampers the Department's ability to ensure a minimum overall level of service in turnaround times for processing.

The Department has not been able to cope with the tens of millions of phone calls it receives each year about child tax benefits and GST credits.

repeated reassurance that their cheques “are in the mail”. They call before payments are due, if benefits have not yet arrived, and even after cheques have been issued and received if the benefits arrive late or if the amount is not what was expected. In addition, they will call to notify the Department if they move and to follow up about changes in family structure.

19.56 The Department has not been able to cope with the tens of millions of phone calls it receives each year about child tax benefits and GST credits. As illustrated in Exhibit 19.4, in the last fiscal year alone roughly 16 million calls were placed about child tax benefits. Although separate statistics were not available on the number of calls about GST credits (they are combined with statistics on calls about personal income tax refunds, for a total of 29 million calls in the last fiscal year), our estimates suggest that calls inquiring about the credits amounted to at least as many as those for child tax benefits in the last fiscal year. In total, we estimate that calls about child tax benefits and GST credits outnumber by more than one third the calls on the Department’s heavily used general enquiry lines.

19.57 We found that telephone service accessibility for the two programs is significantly inferior to the accessibility on general enquiry lines (our concerns about the general enquiry lines are noted in Chapter 14 of this Report, paragraph 14.54). For this last fiscal year, some 90 percent of calls placed on the child tax benefit and GST credit lines got a busy signal, compared with 72 percent on the general enquiry lines. During peak times in three major cities, on or about the payment date, less than 5 percent of calls placed about child tax benefits and GST credits ever got through to the Department, compared with 12 percent on

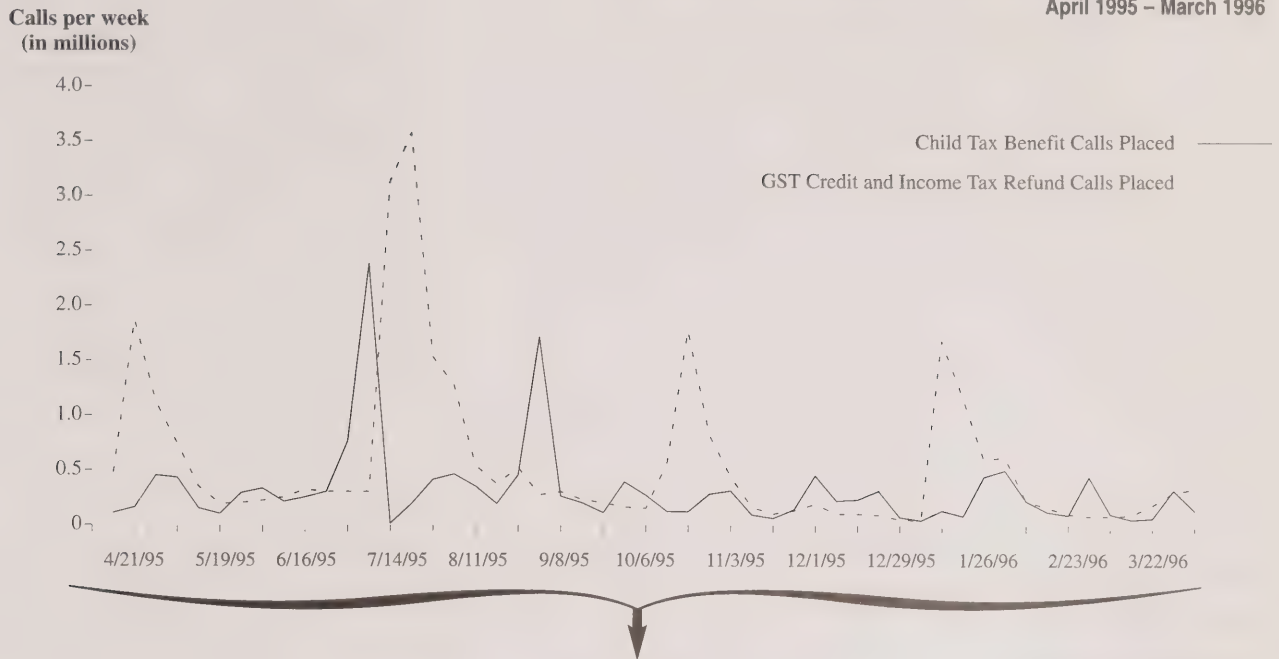
the general enquiry lines during peak periods in those same cities.

19.58 A 1994 departmental report on calling patterns in Toronto and Montreal for the busiest month during the year indicated that, on average, each caller tried nine times to reach the Department but only slightly more than half succeeded in getting into the queue for eventual contact with an agent. Recent departmental statistics show that, on average, callers in the queue can expect to wait almost two minutes before speaking with an agent, but about one quarter of them hang up before they do. It is unclear whether those who hang up do so because the wait is too long or because they receive the information they need from the Department’s voice messaging system.

19.59 Revenue Canada recently instituted voice messaging on phone lines for child tax benefits and GST credits as part of its effort to improve telephone service. Voice messaging provides the same prerecorded message about benefits and/or credits to all callers while they wait to speak to an agent. In addition, an automated enquiries response system was piloted in Montreal and Toronto in the winter and spring of 1996 that provided all callers with full access to a message about the benefit payment. The system accepts up to 200 callers per minute and directs callers to dial another line if they need further information. This system is meant to free agents to handle the calls that require their attention. However, the results of the 1996 pilot tests in Montreal and Toronto suggest that most callers still want to speak directly to an agent. Clearly, telephone access remains a problem area. Subsequent to our audit, the Department informed us that it has expanded the use of the automated enquiry system to two other cities. It also informed us that it has completed a client services re-engineering

Exhibit 19.4

Calls to Child Tax Benefit and GST Credit–Income Tax Refund Lines
April 1995 – March 1996



45 million

GST Credit
and
Income Tax
Refund Calls

29 million

Child Tax
Benefit
Calls

16 million

27 million

General
Enquiries
Calls

Call volumes for the 1995–1996 fiscal year

Our analysis suggests that calls for child tax benefits and GST credits outnumbered by more than a third the calls on the general enquiry lines.

Source: Unaudited departmental records and Office of the Auditor General tabulations

study on departmental telephone enquiries in general, in an effort to improve service overall through expanded use of automation. The Department believes that, at least for simple calls, automation will also help improve accessibility of service on enquiry lines for child tax benefits and GST credits.

19.60 It is noteworthy that Revenue Canada's corporate plan details the Department's general service strategy, which includes consulting with clients on the development of policy and on decisions affecting the design and delivery of its programs and services. It recognizes that an open, consultative relationship

There is little quality control in judging disputes over primary caregiver status; there is no overall monitoring of the practices followed, and decisions taken are typically not subject to review, even on test basis.

with its clients builds a common understanding that strengthens client relations and benefits program delivery. We note that consultative committees are in place for most of the Department's lines of business. However, none have been devised yet specifically for child tax benefits and GST credits, although, through the Department's established Senior Advisory Committee, there have been some consultations with seniors on the delivery of the GST Credit Program. In view of its performance in some key service areas, as noted above, we believe the Department could benefit from the use of a consultative committee in delivering both programs, particularly because they are relatively new and serve a clientele that in many respects is different from those of the Department's other lines of business.

19.61 Revenue Canada should establish standards of service specific to the delivery of the Child Tax Benefit and GST Credit programs and a mechanism for measuring and reporting to decision makers its performance in achieving these standards.

Department's response: The regular and timely delivery of child tax benefits and GST credits is Revenue Canada's primary and uppermost standard of service. The backlog of unprocessed applications described was a temporary situation which followed the transfer of work from one department to the other. For both programs, the Department meets its most important standard by efficiently processing 70 million monthly and quarterly benefit payments each year on time.

The departmental action plan outlines our implementation schedule for other service standards.

Practices vary in judging disputes over primary caregiver status

19.62 Program officials must routinely make judgments in cases where two or more applicants claim they are entitled to child tax benefits for the same child. In these cases, Revenue Canada must determine who is a child's primary caregiver, since only that person is eligible for benefits. Judging disputes over primary caregiver status is not easy, because it may have significant implications for the financial well-being of the disputing parties and because the facts may not be readily discernible.

19.63 We noted that there is little quality control in this area; there is no overall monitoring of the practices followed; and decisions made by a program officer in these sensitive cases are typically not subject to peer or supervisory review, even on a test basis. As a first step in determining primary caregiver status, the Department uses a standard questionnaire (originally prepared and used by HRDC) that each disputing party must complete. It asks them to provide detailed information on the nature and level of care they give to a child. Program officers use the responses as the basis for judging the case. During our field visits, we became aware of inconsistencies in the practices that program officers follow when the primary caregiver is not obvious from the information supplied on completed questionnaires. Some officers may interview both disputing parties, after which they will render a decision. Other officers may contact third parties to confirm or add to the information received. Still others will stop child tax benefit payments from being issued until the disputing parties come to an agreement on their own. The Department informs us that officers are able to refer

any difficult determination to headquarters for consideration.

19.64 As noted, the financial consequences for the affected parties can be significant, and — particularly if benefits are stopped — can also directly affect the well-being of the children for whom the benefits are being paid. The Department's records do not track the number of adjudication cases it deals with.

19.65 Individuals who disagree with the Department's determination of either their eligibility or their entitlements may file a notice of objection and have their case reviewed by an independent party. Appeals officers informed us that some of the most contentious cases are those dealing with determination of primary caregiver status for child tax benefits. However, as we found with the initial determinations, Appeals officers also use different practices in handling these disputes. While the number of formal objections received overall is relatively small, we are still concerned about the potential effects of inconsistent practices on the fair and equitable treatment of all participants in the program.

19.66 **Revenue Canada should establish uniform policies for the determination of primary caregiver status in cases involving disputes among applicants, together with monitoring practices as appropriate for the review of such decisions.**

Department's response: In the determination of these cases, all facts provided by both applicants must be reviewed on an individual basis in order to render a decision. Revenue Canada requires flexibility in practices to ensure fair and equitable treatment of the array of different family situations. The variety of practices observed by the Office of the Auditor General are examples of

appropriate solutions being applied to different situations.

The guidelines will be reviewed to ensure that all applicable practices are incorporated. Appeals Branch will review the operating guidelines for Appeals officers to ensure consistency in resolving disputes.

Initiatives to streamline operations and reduce program delivery costs

19.67 Since child tax benefits and GST credits were launched, Revenue Canada has been working to streamline operations, improve service and reduce administrative costs. Departmental efforts have focussed on voice messaging, an automated enquiry response system, cross-trafficking of phone lines, promotion of direct deposits, and systems redesign aimed at eliminating duplicate processes.

19.68 As noted in paragraph 19.59, voice messaging and the automated enquiry response systems are new initiatives. Recently, Revenue Canada has also experimented with cross-trafficking of phone calls among call sites as a means to better manage its accessibility by phone when one call site reaches full capacity. This initiative was deemed successful and the Department is looking at expanding it. It is also exploring ways to further enhance flexibility in responding to telephone enquiries about the programs.

19.69 The Department has been successful in pursuing the federal government's initiative to expand the use of direct deposits. Direct deposits generate savings in administrative costs. As Exhibits 19.5(a) and 19.5(b) show, over the years the Department's efforts to promote the use of direct deposit have greatly increased the number of child tax benefit and GST credit recipients who use this method. Currently, one family in three who receive either type of benefit receives its payments by direct deposit. This

represents some 24 million benefit payments each year, and has been estimated by the government to generate approximately \$7 million in annual savings in postage, banking and paper costs.

19.70 During this past year, the Department has been implementing the Individual Credit Determination system (ICD) and the Child Credit Management

system. The ICD system was introduced to consolidate two separate systems that were processing similar information to determine entitlements to child tax benefits and GST credits. The Department estimates that the redesign of two systems into one will save \$18 million in maintenance costs over five years. The new system is also meant to provide the Department with the ability to administer any new future credits, whether provincial

Exhibit 19.5(a)

Child Tax Benefit – Direct Deposit Take-up Rate

January 1993 – March 1996

Child tax benefit recipients have doubled their usage of direct deposit from about 24% of all recipients in January 1993 to 48% in March 1996.

Source: Unaudited
departmental records

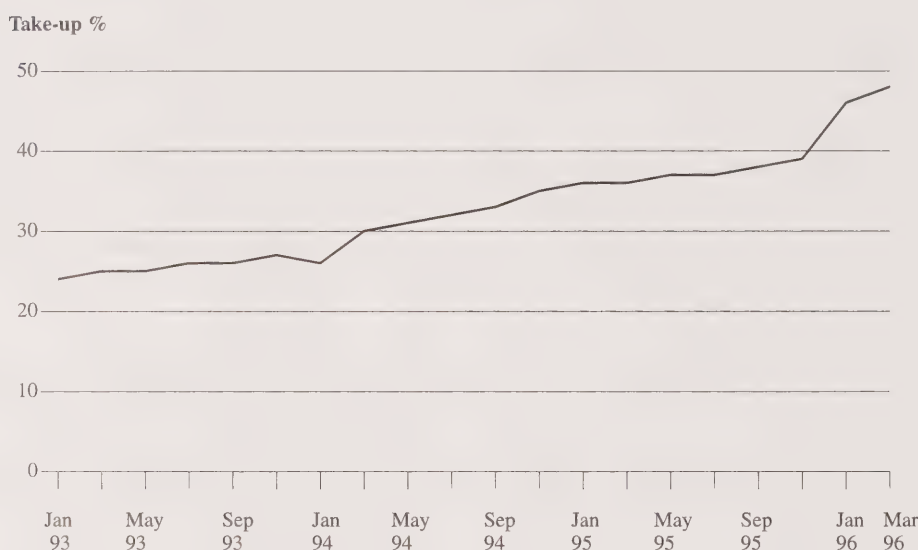


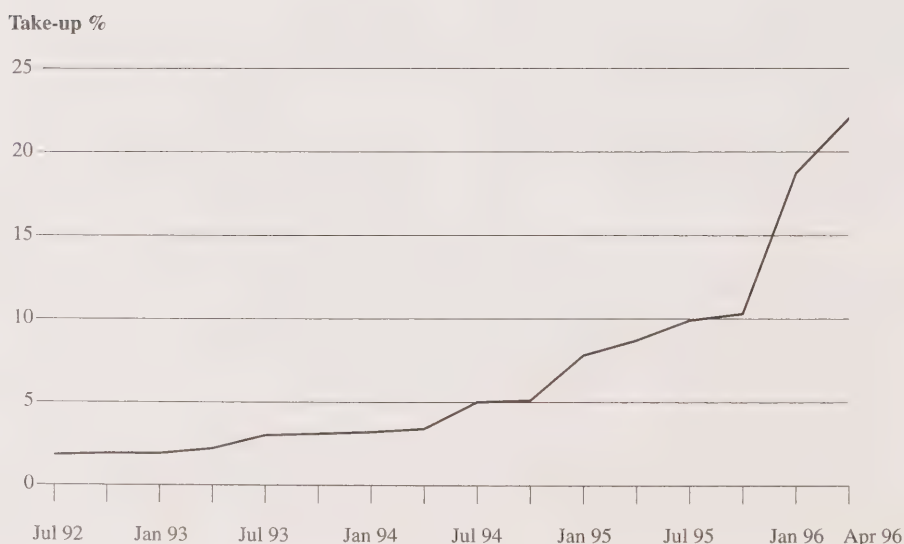
Exhibit 19.5(b)

GST Credit – Direct Deposit Take-up Rate

July 1992 – April 1996

Use of direct deposit by GST credit recipients has increased from about 2% of all recipients in July 1992 to 22% in April 1996.

Source: Unaudited
departmental records



or federal, through the tax system should that be required.

19.71 Although Individual Credit Determination may achieve efficiencies for the Department in the long run, its launch was hampered by systems problems that disrupted service to affected recipients of GST credits and child tax benefits and that incurred extra administrative costs. For example, when the system was first used in July 1995 to compute entitlements for the new benefit year, it missed more than 40,000 clients of the GST Credit and Child Tax Benefit programs. Payments were subsequently issued and mailed to affected clients by month's end. As well, about 90,000 married or common-law recipients of GST credits had their benefits calculated as though they were single, which reduced their maximum supplement from \$199 to \$105; adjustment cheques were issued thereafter. The Department indicates that most affected clients received their adjustment cheques within two weeks of the original mailing and that system problems identified in this paragraph have now been corrected.

19.72 To address concerns raised about the ICD system, the Department established a steering committee for benefit program systems. An initiative under the steering committee was to review the stability of the ICD system. At the completion of our audit, this review was still under way. Our observations on controls over systems development are found in paragraphs 19.124 to 19.128.

19.73 The second system introduced by the Department within the last year was the Child Credit Management system (CCM), which replaced HRDC's system for processing eligibility determinations. It is expected to yield administrative savings of \$2.3 million per year over the cost of the separate systems previously

maintained by HRDC and Revenue Canada, which contained overlapping, duplicate information. This system, like the ICD, is meant to accommodate potential provincial requirements. And like ICD, the system had start-up delays when it was implemented in February 1996. These led to some delays in processing child tax benefit applications, creating a new set of backlogs that caused some clients to wait several months before receiving their first benefit cheques.

Verification and Enforcement

Controls are necessary to ensure overall integrity and fairness of programs

19.74 When new programs such as the Child Tax Benefit and GST Credit programs are introduced to deliver substantial social benefits to millions of families and individuals, it is prudent to introduce controls to lessen the risks of non-compliance (that is, error, fraud and abuse). Non-compliance not only adversely affects a government's ability to meet and fund social policy objectives but also undermines integrity and fairness in social programs. Some individuals and families may get more than their fair share of assistance, leaving the government less able to help and respond to those truly in need.

19.75 Verification and enforcement activities are critical in administering large and substantial benefit programs because of the social and financial risks involved. These programs need appropriate systems to verify an individual's eligibility for benefits, to verify the amount of benefits involved and to detect and prevent fraud and abuse.

19.76 Our observations on the Department's performance in the areas of verification and enforcement lead us to conclude that Revenue Canada's existing control environment is not adequate to

Non-compliance not only adversely affects a government's ability to meet and fund social policy objectives but also undermines integrity and fairness in social programs.

In determining eligibility for these programs, Revenue Canada relies almost exclusively on the honour system. The Department generally requires no documentation, such as a birth certificate, to enrol a child under either program.

ensure equitable program delivery, and may be exposing the public purse to losses. These observations are equally valid for HRDC in its area of responsibility until August 1995 — determining basic eligibility for child tax benefits. We believe that verification and enforcement require much more attention than they have received to date. The current exposure to financial risk is large. The potential for errors, abuse and fraud to go undetected is high. During the audit, Revenue Canada indicated that it was in the process of finalizing a new divisional structure that would give a higher priority to its benefit programs, and would include a section dedicated to quality assurance as well as compliance activities. At the conclusion of our audit, work on this division was still under way.

Fundamental checks and balances are lacking

19.77 Our examination revealed that some essential controls are in place in Revenue Canada's existing control environment. For example, the Department will match spousal information, when information to do so is available, to generate measures of family income for benefit calculations. Furthermore, it attempts to identify duplicate GST credit applicants, non-residents, and other individuals who may not qualify for benefits. In addition, the Department discontinues child tax benefit payments after a limited period of time if returns have not been filed by the applicant and, where appropriate, his or her spouse.

19.78 However, our examination also revealed five areas in which we believe fundamental checks and balances are lacking for GST credits and/or child tax benefits:

- enrolling children for benefits;

- accounting for deceased children on the benefit roll;

- processing benefits that are incomplete or contain inconsistent information;

- reconfirming eligibility; and

- maintaining source documents.

19.79 Enrolling children for benefits.

The first area in which we feel that appropriate checks and balances are lacking is the enrolment of children for GST credits and child tax benefits. In determining eligibility for these programs, Revenue Canada relies almost exclusively on the honour system. Unlike other jurisdictions, the Department generally requires no documentation, such as a birth certificate, to enrol a child under either program. The main exception is that proof of birth is required to enrol for child tax benefits either a Canadian child who is over 11 months of age or an immigrant child of any age. (For GST credits, there is no such requirement.) Revenue Canada has indicated that at the time it took over child tax benefit eligibility in August 1995, it was continuing with HRDC's approach to verifying and processing applications. We note that HRDC began a review of its birth verification procedures in 1994. However, when the transfer of child tax benefit eligibility to Revenue Canada was announced later that year, HRDC's work on this review ceased. Revenue Canada's reliance on the honour system for processing applications contrasts with its own practices for many tax credits and deductions that rely on third-party information reporting and that are verified either pre-assessment or post-assessment on a targeted or random basis.

19.80 For child tax benefits, we attempted to analyze whether the number of newborn children for whom benefits were being paid was generally reasonable.

We used the 1994–95 benefit year records for our analysis, since the 1995–96 benefit year was still in progress at the time of our audit. We also limited our analysis to children on the benefit roll recorded as born in 1993, because some children born in 1994 for whom benefits would be paid would not yet have been enrolled by the end of the 1994–95 benefit year. This is because some families may apply for benefits several months after the birth of child. There are also inherent time lags in the processing of applications received by the Department.

19.81 To assess the overall reasonableness of the number of children receiving child tax benefits who were recorded as born in calendar 1993, we compared departmental information with our own benchmark estimate of maximum expected enrolments. (This estimate was based on departmental data and relevant vital statistics and population information produced by Statistics Canada.) All children who are born are not necessarily entitled to a benefit. Therefore, in establishing our benchmark estimate we needed to determine an appropriate entitlement rate that would allow for a proportion of children who do not qualify for benefits either because they are not eligible, for instance if they reside outside of Canada, or because they are not entitled due to family income being too high. As illustrated in Exhibit 19.6(a), the population of newborns for 1993 as per Statistics Canada records, adjusted for immigrants and neonatal deaths, amounted to about 389,000. Using what we determined to be the maximum reasonable entitlement rate of 88 percent (the actual entitlement rate could be lower), this translates into an entitled 1993 newborn population of 343,000. To arrive at a maximum benchmark estimate of the number of newborns one could reasonably

expect to find on the benefit roll, we used the size of the entitled 1993 newborn population as a base and adjusted the figure to take into account plausible take-up rates for newborn enrolments.

19.82 We found that the number of children on the child tax benefit roll who were recorded as born in 1993 exceeded our range of benchmark estimates for plausible take-up rates. We are concerned that this may be an indication that some newborns on the benefit roll do not belong there. Such a problem could be caused either by incorrect reports of newborns or by the Department's failure to detect that families of some otherwise entitled newborns do not qualify for benefits because family income is too high.





19.83 The precise extent of the apparent problem we identified with newborn enrolment depends critically on the take-up rate of the program. (The lower the take-up rate among applicants who are genuinely entitled to receive benefits for their newborns, the higher the estimated number of newborns on the benefit roll who do not belong there.) Although the actual take-up rate has not been measured, we believe it is unlikely to be higher than 98 percent of entitled children and may be well below this level, for the following reasons:

- some families entitled to child tax benefits might not be aware of the program;
- other entitled families might incorrectly believe that their income is too high to qualify for benefits;
- still others may incorrectly perceive that obtaining the child tax benefit would result in the loss of other forms of social assistance; and
- the requirement to file a tax return in order to qualify for benefits could discourage some families from applying.

We found that the number of children on the child tax benefit roll who were recorded as born in 1993 exceeded our range of benchmark estimates for plausible take-up rates. We are concerned that this may be an indication that some newborns on the benefit roll do not belong there.

Exhibit 19.6(a)

**Population Statistics on 1993
Newborns and Benchmark
Estimates of Those Entitled to
Child Tax Benefits**

-  Population of 1993 newborns per Statistics Canada ¹
-  Population of 1993 newborns at 88% entitlement
-  Benchmark estimate of 1993 newborns at 98% take-up rate
-  Benchmark estimate of 1993 newborns at 90% take-up rate

¹ Adjusted for newborn immigrants & neonatal deaths

≅ Approximation

Source: Statistics Canada records, departmental records and Office of the Auditor General tabulations

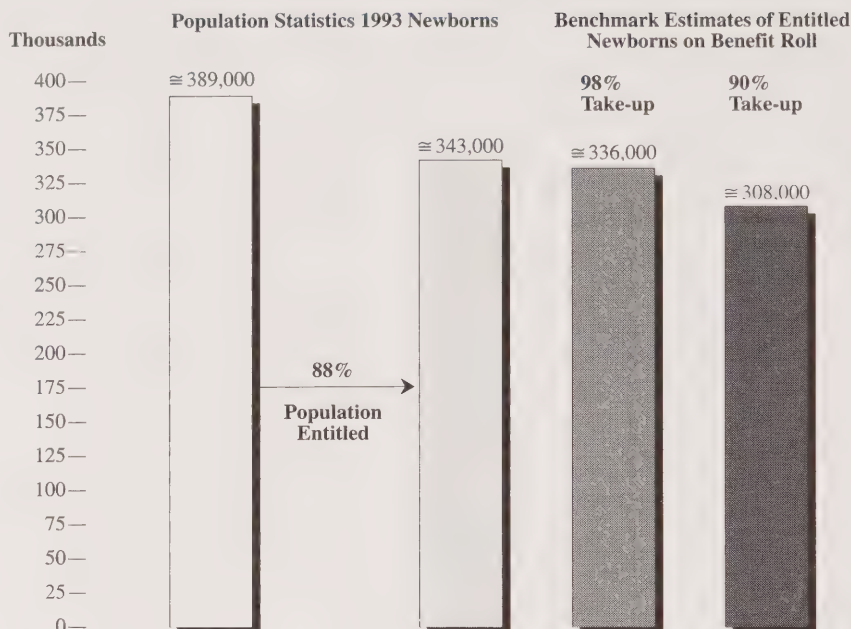





Exhibit 19.6(b)

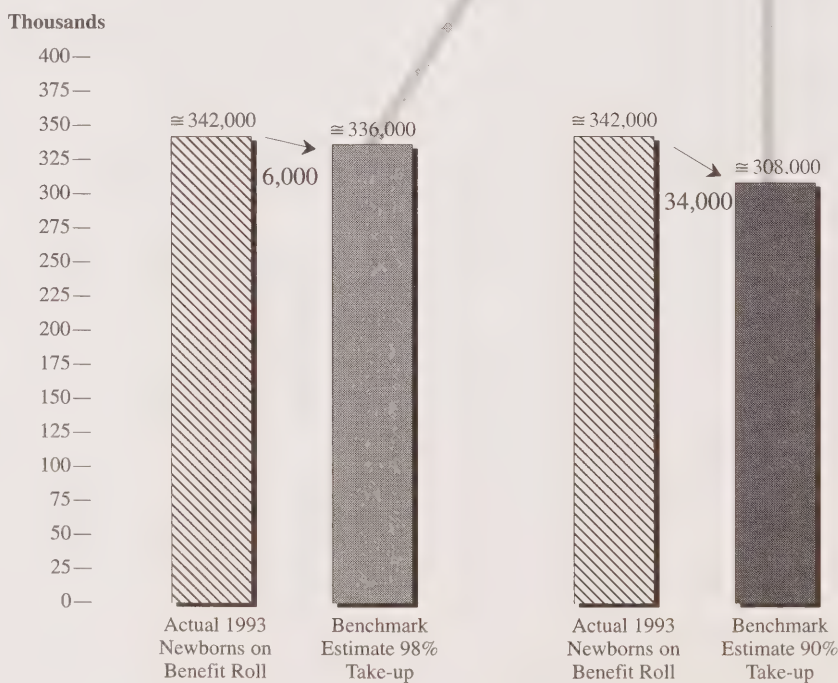
**Comparison of Actual 1993
Newborns on Child Tax Benefit
Roll with Benchmark Estimates
of Entitled 1993 Newborns**

Actual number of newborns on benefit roll exceeds expected number for 1993 even at a 98% take-up rate.

-  Actual number of 1993 newborns on Revenue Canada's benefit roll
-  Benchmark estimate of 1993 newborns at 98% take-up rate
-  Benchmark estimate of 1993 newborns at 90% take-up rate

≅ Approximation

Source: Departmental records and Office of the Auditor General tabulations



19.84 Researchers in the United States have identified similar reasons as the explanation for the low take-up rate of a broadly similar program, the Earned Income Credit. Only about 75 to 86 percent of all entitled families are believed to have received this credit in tax year 1990. As we have noted elsewhere, the take-up rate for child tax benefits is likely to be higher because the benefits in Canada are available to a higher percentage of families than are the earned income credits in the U.S. In our opinion, somewhere between 90 and 98 percent is a more plausible take-up rate for the Child Tax Benefit Program.

19.85 As Exhibit 19.6(b) shows, the number of children recorded on the Department's benefit roll as born in 1993 exceeds our maximum benchmark estimate of appropriate enrolment even if the actual take-up is as high as 98 percent. If the actual rate is 98 percent, the enrolment level exceeds our estimated maximum by 2 percent; if it is at the other end of the range, at 90 percent, the enrolment level exceeds our estimated maximum by nearly 10 percent.

19.86 The potential financial implications are quite serious. Our analysis suggests that between about 6,000 and 34,000 children enrolled as born in 1993 may have been improperly included on the 1994-95 benefit roll, for the range of our plausible take-up rates and assuming our estimated maximum level of enrolments. We are unable to give a more precise estimate, because the information we needed to do so was not available. For the estimated range of children enrolled as born in 1993 who may have been improperly included on the 1994-95 benefit roll, the improper payments for this one year alone would range from \$5.9 million to \$31.6 million. The problem takes on a multiplier effect in that

once an unentitled newborn has been placed on the roll, benefits will continue to be paid over the years unless either the problem is detected and corrected or there is a change in family status or income that impacts on entitlement. Given that the control environment has not changed in the area of child enrolments since child tax benefits were first introduced, we are concerned that many of these apparently unentitled 1993 newborns likely have already been in pay status for three to four years. Moreover, there are also other unentitled newborns who could have been improperly added to the roll for 1994 and 1995. We recognize that in a major social benefit program such as child tax benefits, it would be unrealistic to expect a complete absence of non-compliance. Some degree of error, fraud, and abuse is to be anticipated even with a well-designed verification, monitoring and enforcement regime. However, we are concerned that given the current regime the exposure to risk may be excessive, and it needs to be reduced.

19.87 The actual extent of the problem with newborn enrolments will not be known unless the Department undertakes appropriate initiatives to measure program take-up and non-compliance. However, we think the potential consequences are sufficiently serious that the Department needs to investigate the causes and the extent of the apparent problem of some newborns being on the benefit roll who should not be there and, where appropriate, strengthen its procedures for verifying the eligibility of newborns and family income for purposes of entitlement.

19.88 Our concerns do not extend to the enrolment of older children for child tax benefits because most of these children have been subjected to more intensive verification efforts, either under the former Family Allowances Program from

The actual extent of the problem with newborn enrolments will not be known unless the Department undertakes appropriate initiatives to measure program take-up and non-compliance.

which many were automatically included or under the Child Tax Benefit Program. Furthermore, we found that overall statistics on total child enrolment were not implausible when compared with Statistics Canada estimates of the child population overall. But, as noted above, with respect to recent enrolment of newborns this is not the case.

19.89 We were unable to perform a similar analysis of child enrolments in the GST Credit Program: the Department maintains only limited information on program participation, and suitable third-party information against which to check overall enrolment levels could not be obtained. However, our findings on child tax benefits only heighten our concerns about the lack of verification of children for whom GST credits are claimed.

19.90 Accounting for deceased children on the benefit roll. The second area in which we found that appropriate checks and balances are lacking is accounting for deceased children who have been on the child tax benefit roll. (For GST credits, this is a lesser concern because of the legal requirement to apply annually, which also requires providing up-to-date information on numbers of qualified dependants.) Revenue Canada relies (as did HRDC until August 1995) almost exclusively on information volunteered by program participants concerning the deaths of enrolled children. While participants do have an obligation to report changes to the Department that could affect eligibility (and can be charged penalties for failing to do so), it is unclear to what extent they know about their duty to report the death of a child enrolled in the program.

19.91 We estimate that over one fourth of all deaths of enrolled children during calendar years 1993 and 1994 were not

reported to the Department. Our analysis was based on a comparison of departmental data with relevant vital statistics information produced by Statistics Canada. Just as with newborn enrolments, the Department needs to immediately investigate the extent of this problem and consider strengthening its procedures for accounting for deaths of enrolled children.

19.92 Processing benefits with incomplete or inconsistent information. The third area where we think checks and balances need to be improved is the processing of GST credit and child tax benefit applications when information supporting entitlements is incomplete or inconsistent.

19.93 In both programs, the Department processes benefit payments even when crucial information affecting entitlements is uncertain. The most common type of missing or inconsistent information is spousal information (marital status, spousal social insurance number and spousal income). In the absence of complete information, the Department generally makes an assumption, which is then used as the basis for computing benefit payments. The Department does not routinely contact the applicant for clarification in such cases, even after the initial assessment. Consequently, the remaining payments over the benefit year will normally continue to be based on the Department's initial assumption. Such a policy creates a high potential for both overpayment and underpayment of benefits.

19.94 During our visits to tax centres, we observed that many child tax benefit applicants provide inconsistent details about their marital status. This raises questions about the quality of marital status information the Department receives overall. This is an important

issue, because incorrect information about marital status not only can result in improper child tax benefit and GST credit payments but also can lead to inappropriate assessments of deductions and credits such as the federal child-care deduction, equivalent-to-spouse amount and spousal amount, as well as provincial sales tax credits.

19.95 The Ottawa Tax Centre recently reviewed inconsistencies in reported marital status between Ontario child tax benefit applications and previously submitted tax returns. The review focussed on new child tax benefit applications processed during the fall of 1995. The number of inconsistencies identified amounted to about 1,300 cases out of 35,000 applications processed in that period. At the conclusion of its review, the Tax Centre had determined that previous tax assessments and/or benefit payments needed to be reassessed for 283 families. For these families, the Centre concluded that either too little tax had been paid in the previous three years or overpayment of benefits had been made (or both) because the family had provided incorrect information on marital status. Tax, provincial credits, and GST credit and/or child tax benefit adjustments were computed; the computed three-year net total increase in taxes and reduction in previous benefits and credits amounted to more than \$500,000, representing about \$1,800 for each of the 283 families. Overpayments of GST credits and child tax benefits accounted for more than half of this total. If the applications reviewed are representative of those received nationally, similar reviews of other applications received during the 1995–96 benefit year alone could be expected to yield an additional five to six million dollars in tax reassessments and benefit adjustments.

19.96 The Ottawa Tax Centre initiative was undertaken as a pilot project. At the conclusion of our audit, the Department was considering plans to extend the project to a national level.

19.97 The Department continues to make assumptions when confronted with missing or inconsistent information on child tax benefit and GST credit applications, despite the clear risks involved. It is still not its standard practice to obtain clarification, even following the initial assessment.

19.98 Reconfirming eligibility.

Because a child is enrolled for child tax benefits for up to 18 years on the basis of a single application, it is possible that the information on which eligibility is based may become outdated. (By way of contrast, GST credit recipients are legally required to apply annually, thereby “reconfirming” their eligibility status.) To deal with potential inaccuracies in its own departmental records for child tax benefits when it was responsible for determining eligibility, HRDC developed plans to conduct reconfirmation exercises for certain participants who met specified criteria. This exercise, which was to be carried out with the assistance of Revenue Canada, was deemed essential to reduce the risk of paying out benefits to recipients who no longer qualify for benefits. Up to 94,000 participants in a given year were to be contacted by phone to confirm their marital status and the eligibility of enrolled children. Although a reconfirmation exercise was planned for each benefit year beginning with 1993–94, the extent to which the exercise was carried out in the initial year is unknown (no records of this exercise exist). In the following year, due to resource shortfalls, only a small fraction of the planned reconfirmations were completed. For the 1995–96 benefit year, the reconfirmation

Many child tax benefit applicants provide inconsistent details about their marital status. Incorrect information about marital status not only can result in improper child tax benefit and GST credit payments but also can lead to inappropriate assessments of deductions and credits.

To date, substantial effort has been directed at planning reconfirmation exercises, but only a small portion of those planned have been carried out.

exercise became Revenue Canada's responsibility. At the end of our audit, which coincided with the end of the 1995–96 benefit year, the Department had completed only a very small number of the planned reconfirmations.

19.99 We believe that periodic reconfirmation of eligibility information with child tax benefit recipients would be a prudent management practice, particularly if the recipients were required to provide written responses. To date, substantial effort has been directed at planning reconfirmation exercises, but only a small portion of those planned have been carried out. Clearly, Revenue Canada needs to devote more serious attention to ensuring that benefits for this multi-billion dollar program are paid on the basis of accurate and up-to-date information. The implementation of realistic and appropriate reconfirmation procedures would be a necessary first step.

19.100 Maintaining source documents.

It is standard practice to maintain copies of source documents such as application forms and supporting documentation when an individual applies for social benefits. In the event that computer records on a client appear to be incorrect, are unintentionally modified or are destroyed, source documents provide an important paper trail to follow in resolving the problem. Moreover, these documents generally are essential for the successful prosecution of cases involving fraud and other program abuse.

19.101 To investigate whether child tax benefit payments were properly supported, we asked HRDC and Revenue Canada to supply us with supporting documentation on random samples of participants who received benefit payments during both departments' respective periods of

responsibility for eligibility determination. Neither department was able to provide us with all requested documentation. In particular, HRDC was able to locate requested documents for only 148 participants of the 185 child tax benefit participants (80 percent) in the sample it was given. Revenue Canada provided all requested documents for only 26 of the 65 participants (40 percent) in the sample it was given. We note that the documents it did provide were those involving applications that were processed by the Department since taking over responsibility for child tax benefit eligibility. We were informed by Revenue Canada that the remaining documents could be located only by using a significant amount of additional resources.

19.102 Given the inability of the departments to provide all requested source documents, we are unable to confirm that all required documentation has been received from program participants. Moreover, we cannot verify that the information used to determine eligibility is consistent with the information supplied by applicants. Finally, we cannot comment on the authenticity of the eligibility information contained in the departments' data banks (HRDC's until August 1995 and Revenue Canada's thereafter). The inability of the departments to readily access all source documents for child tax benefits could impact on Revenue Canada's ability to undertake enforcement activities involving benefits paid (past, present and future) based on prior years' applications and related source documents. It is noteworthy that in the case of GST credits, we were able to trace supporting information contained in the applications on personal tax returns, as required, and observed no discrepancies.

Risks to GST credits may be higher

19.103 In the preceding paragraphs, we have assessed the potential financial impact of the lack of fundamental checks and balances in the Child Tax Benefit Program for the key area of child enrolments. As indicated in paragraph 19.89, although we could not obtain the necessary information to perform a similar financial risk assessment for GST credits, we are equally concerned about the potential financial risk to which this program is exposed by the lack of verification of claimed dependants. In addition to that risk, there are other areas specific to GST credits, as discussed below, that suggest the program may be more vulnerable than child tax benefits to error and abuse. Our concerns are heightened because of the year-over-year increases in total GST credits paid, without adequate supporting analysis to ensure that those amounts are reasonable.

19.104 We note, for example, that the number of GST credit recipients grew by 8 percent between the 1992–93 and 1994–95 benefit years. Over this same period, the increase in total GST credits, from \$2.5 billion to \$2.8 billion (a 12 percent increase), has outpaced by 50 percent the growth in the number of recipients. The Department has done no analysis of the trends in benefit payments and participation levels. We think the causes and implications of these trends warrant careful investigation.

19.105 There are three respects in which GST credits may be even more vulnerable to error and abuse than child tax benefits as a result of the way that credits are currently processed. First, whereas a child tax benefit applicant is at least required to provide basic information about each child claimed for benefits (such as name, date of birth, relationship to applicant and period of residence with applicant), a GST

credit applicant is required to state only the total number of children being claimed. On the basis of such limited information, it is not possible for the Department to check even whether the children for whom benefits are claimed meet the age and residency requirements of the program.

19.106 Second, the spouse of a GST credit recipient is not legally required to file a tax return in order for the applicant to receive benefits. If the spouse does not file, the Department must rely on the spousal income figure stated on the recipient's application to compute GST credit benefits. The amount reported by the applicant may not reflect true spousal income if, for example, the spouse does not keep accurate income records in the absence of a filing requirement or the applicant is not aware of the spouse's exact income. Moreover, in cases where the applicant does not provide any information about spousal income, the Department generally assumes that the spouse has no income rather than contacting the applicant for clarification.

19.107 Third, the family member who receives the GST credit may vary from one year to the next at the family's discretion, whereas the child tax benefit recipient in the family normally remains the same. This makes it more difficult for the Department to track the level of payments going to a family and to prevent duplicate payments when applications have been submitted by more than one member of the same family.

19.108 Revenue Canada should institute an adequate and appropriate control environment to have reasonable assurance that only eligible recipients receive child tax benefits and GST credits and receive them in the correct amounts. Attention should be given to the following areas: enrolling children

There are other areas specific to GST credits that suggest the program may be more vulnerable than child tax benefits to error and abuse.

The failure to maintain accurate data and program statistics not only impacts on stakeholders who rely on such information but also inhibits the Department's ability to properly monitor its programs and identify problem areas for timely corrective action.

for benefits, accounting for deceased children, processing benefits with incomplete or inconsistent information, reconfirming eligibility and maintaining source documents.

Department's response: The Department has already taken steps to build an appropriate control environment. In order to better account for deceased children on the benefit roll, Revenue Canada is negotiating with one province to obtain third-party information, and intends to expand the process, subject to agreement by each provincial jurisdiction. The review of inconsistencies in reported marital status, which was conducted as a pilot at the Ottawa Tax Centre, has been extended to a national project. The Department is also actively carrying out an eligibility reconfirmation project in each tax centre. No further action is required to improve the management of source documents, since this was resolved when Revenue Canada implemented the new processing system in February 1996.

Statistics used for monitoring are flawed

19.109 Our audit noted significant deficiencies in the quality of information produced to monitor overall performance of the programs. Revenue Canada routinely collects data on the GST Credit and Child Tax Benefit programs and generates regular statistical reports. This information is intended to be used in monitoring program performance and, often, to meet the needs of various stakeholders such as Statistics Canada, the Department of Finance and provincial school boards. During our audit, we noted that Revenue Canada had not taken appropriate steps to ensure the accuracy and completeness of its GST credit and child tax benefit statistics on program performance, and of the raw data used to generate them. The examples below

illustrate the severity of the problems we identified.

19.110 In reviewing quarterly statistics on GST credits, we noted serious flaws in the 1995–96 statistics generated for the Department's internal use to monitor the overall performance of the program. For example, the number of recipients during the benefit year was grossly overstated, suggesting approximately 2 million more than the actual number. Similarly, with child tax benefits we identified serious and persistent errors in the Department's monthly statistics on births and deaths of children for whom child tax benefits were being paid. A comparison of the birth statistics for enrolled children with benchmark estimates suggested that as many as one in three newborns on the 1993–94 child tax benefit roll did not belong there. Through our subsequent analysis of raw program data, we found that the departmental statistics were inaccurate and had been so since they were first produced. These statistics were generated not only for internal monitoring but also for use by other key stakeholders. The Department was not aware of the deficiencies in its statistical reports for child tax benefits or for GST credits.

19.111 The Department's poor performance in generating reliable statistical information essential for monitoring is a significant concern. The failure to maintain accurate data and program statistics not only impacts on stakeholders who rely on such information but also inhibits the Department's ability to properly monitor its programs and identify problem areas for timely corrective action.

19.112 Revenue Canada should take appropriate measures to ensure the reliable and accurate generation of key program statistics meant for either

**monitoring purposes or use by other
key stakeholders.**

Department's response: The Department is reviewing statistical information that is generated in order to improve its accuracy and completeness.

**Program monitoring has been
inadequate**

19.113 We expected that Revenue Canada would be carefully monitoring Child Tax Benefit and GST Credit program statistics to learn about client profiles and to evaluate program delivery. One key aspect of monitoring would involve comparing enrolment statistics against measures of expected enrolments based on data from independent third-party sources, similar to the comparisons we performed for child tax benefit enrolments (see paragraphs 19.81 to 19.86). However, we found that the Department had not performed any such comparisons. Another aspect would be to examine the sources of errors that resulted in overpayment or underpayment of benefits.

19.114 We found that, until very recently, the Department had not used its statistics on GST credits and child tax benefits to develop client profiles or to evaluate program performance in any meaningful way. Recently, however, it has begun to analyze overpayments in the Child Tax Benefit Program. A draft departmental report reveals that outstanding overpayments since the inception of the program stood at \$69 million as of 31 March 1996. The report indicates that there are obstacles to the collection of some of these overpayments. For example, child tax benefit participants who have received excess payments may receive no continuing child tax benefit payments or tax refunds against which the liabilities

can be offset. Studies are being planned to explore the feasibility of improving debt collection and reducing the level of overpayments generated.

19.115 The Department has yet to undertake a similar analysis of GST credit overpayments. At our request, it produced an estimate of overpayments made during the 1994–95 benefit year. Based on a manual calculation of overpayment amounts from more than 75 quarterly and supplementary reports on cheque issues for the year, the Department estimated that overpayments amounted to \$19.8 million. No information is available to track the recovery of GST credit overpayments, and no analysis has been undertaken to learn about the causes of overpayments or ways to reduce them.

19.116 While we recognize that these overpayment figures amount to less than one percent of total amounts paid, on either an annual or cumulative basis, in absolute terms the overpayments are still financially significant. Given that little analysis or scrutiny has been performed in this area, there could be cost-effective opportunities to reduce the balances, potentially by millions of dollars.

19.117 Overall, we believe the Department needs to devote more attention to monitoring its performance in these programs. As cited, one key aspect would be ensuring periodically that aggregate statistics on key program variables compare reasonably well with benchmark statistics on the same variables; another would be following up on known overpayments. We have already commented on the potential financial consequences if excess child enrolments exist on child tax benefit rolls. Similarly, as noted above, there are financial implications to insufficient monitoring of benefit overpayments. We do acknowledge the Department's draft

report on child tax benefit overpayments as a necessary first step.

19.118 Revenue Canada should monitor overall performance of the programs periodically to ensure the reasonableness of total benefits being paid against benchmark statistics on key program variables, and develop improved systems for the control and collection of known overpayments.

Department's response: The Department has in fact been conducting a number of activities to monitor the performance of its benefit programs. A new divisional structure was initiated, which includes a section dedicated to quality assurance and compliance activities. From the Child Tax Benefit overpayment report, an action plan has been created and is being implemented. The Department has also initiated a thorough evaluation of its program monitoring requirements, including the integrity of internal statistics and the availability of external data sources. Finally, the collection of benefit overpayments will be expanded by automating links to the Department's well-established electronic collection system. These automated links will be in place in February 1997.

No formal enforcement strategy against fraud and abuse

19.119 Although the Child Tax Benefit and GST Credit programs have been operating for several years now, the Department still has not established a formal enforcement strategy to prevent and protect against fraud and abuse. This is particularly worrisome given the weaknesses we observed in controls over the processing of benefit payments in general, and in view of the billions of dollars spent yearly under these programs. The absence of an enforcement regime for the programs contrasts sharply with approaches adopted by other jurisdictions

administering programs broadly similar to child tax benefits and GST credits. Our visits to four provincial social assistance administrations and our review of the U.S. experience shows that these jurisdictions have developed strategies and procedures to protect against fraud and other abuse in their social benefit programs. These jurisdictions allocate resources specifically to such activities. Marital status and undeclared income were the main areas of enforcement activity identified by the provincial officials with whom we spoke. One province hired additional staff specifically to identify ineligible recipients.

19.120 The experience of the United States Internal Revenue Service (IRS) with its Earned Income Credit (EIC) program is also relevant. The EIC has been subject to wide-scale error and abuse. Prior to the 1986 tax reform in the United States, there was generally no requirement to provide documentation to substantiate dependency claims or to substantiate the claim for the Earned Income Credit. Starting with the 1987 tax year, new laws required social security numbers (similar to social insurance numbers in Canada) for all dependants aged five years or older claimed for personal exemptions on tax returns. In testimony before Congress, the IRS noted that the number of dependants claimed on tax returns fell by seven million between tax years 1986 and 1987 (many of whom likely would have been claimed for the Earned Income Credit). The drop in the number of dependants was estimated to equate to at least \$2.8 billion in additional revenue for the Treasury. The Earned Income Credit has continued to be a problem area for the IRS. For tax year 1988, it was reported that of the \$5.6 billion awarded in earned income credits that year, about \$1.9 billion (34 percent) were awarded erroneously, due primarily

The Department still has not established a formal enforcement strategy to prevent and protect against fraud and abuse. This is particularly worrisome given the weaknesses in controls and in view of the billions of dollars spent yearly under these programs.

to errors in taxpayers' filing status and the number of dependant children claimed. Since then, the law in the U.S. has been further amended to require social security numbers for all dependants claimed for either earned income credits or personal exemptions. While observed problems with non-compliance in the United States are not a sure indicator of similar problems in Canada, the evidence in the United States as well as numerous studies on compliance behaviour in general would suggest that some individuals in Canada may well attempt to cheat the system if given the opportunity to do so. Purely from a risk-management perspective, it would be prudent to ensure that sufficient controls exist to prevent substantial numbers of ineligible or unentitled participants from entering the child tax benefit roll. However, our audit found that this is not the case.

19.121 Exhibit 19.7 provides examples of practices of other jurisdictions in the area of verification and enforcement for programs broadly similar to the Child Tax Benefit and GST Credit programs.

19.122 Revenue Canada should establish and implement an appropriate

enforcement regime for child tax benefits and GST credits to detect and prevent abuse and other non-compliance in the programs.

Department's response: This is addressed in the Department's action plan.

Quality of data and program logic supporting benefit payments is unknown

19.123 Revenue Canada accepted a high level of risk in not adhering to specific aspects of generally followed standards in the area of systems development when it developed new key systems supporting the Child Tax Benefit and GST Credit programs. These systems, the Individual Credit Determination (ICD) system and Child Credit Management (CCM) system, are crucial to the delivery of billions of dollars in benefit payments to millions of families each year.

19.124 There are three key areas in which the Department has not adhered to generally followed standards in the area of systems development. First, it failed to maintain essential records of changes pertaining to the conversion of data on recipients from old systems to new systems. Documentation was also missing

We visited four provincial social assistance administrations and reviewed U.S. practices in administering its Earned Income Credit Program to compare enforcement activities against those of Revenue Canada's for programs broadly similar to Child Tax Benefit and GST Credit. We found that in these other jurisdictions, the trend is toward increased enforcement activities. The following are typical examples of practices being used to deal with and prevent potential fraud and abuse.

- Processing of applications only after verification of the applicants and their dependants with birth certificates and/or picture identification. The U.S. requires social security numbers for dependants claimed.
- Benefits are cut off or reduced if the documentation required by recipients is not received or is incomplete.
- Monthly summary information is closely monitored to identify potential problems, trends and reasonableness of payments given out.
- Home visits are selectively used to confirm eligibility and family status.
- Recipients must sign a form annually or bi-annually to reconfirm their marital status, income, child custody, etc.
- Random audits are performed to measure the extent of non-compliance, develop profiles of non-compliant recipients, and develop strategies accordingly.

Exhibit 19.7

Examples of Verification and Enforcement Practices of Other Jurisdictions

Revenue Canada's approach to some aspects of generally followed standards for systems under development has lacked the necessary level of rigor.

or incomplete in even such key areas as problem identification, resolution and follow-up activities. Incomplete documentation is a concern because it inhibits the Department's ability to effectively and efficiently correct program flaws and to modify systems later. It also limits the opportunity for independent reviews of new systems to ensure an acceptable level of quality. Second, the Department has compromised the testing of core applications in order to meet in-house deadlines. Third, the lines of responsibility for making changes to programs are not always clear, and formal approvals are not always present. This increases the risk that incorrect and unapproved changes will be made; indeed, we are aware of incorrect changes that have been made to these systems.

19.125 ICD development. We note that the ICD development schedule was shortened from 18 months to 9 months to meet internal deadlines. The time available for development and testing was significantly reduced, increasing the risk of inadequate quality control, errors and systems failure, particularly given the absence of contingency planning in the form of specific measures to mitigate the risks. Several problems did arise when ICD was implemented. We note that an internal review of the stability of the system was initiated, but not until several months after it was operational. At the completion of our audit, the review was still in progress.

19.126 CCM development. In the case of CCM, the system responsible for determining eligibility for child tax benefits, we noted that both system and user testers reported an inability to test the system fully before it went "live". The system was implemented according to schedule, but was immediately withdrawn for one week due to problems with its

operations. For several weeks, users did not have full functionality, which built to a backlog of unprocessed child tax benefit applications. Full functionality was available two months later.

19.127 We find that Revenue Canada's approach to the above-noted aspects of generally followed standards for systems under development — such as ICD and CCM, which deliver billions of dollars in benefits to millions of individuals and families each year — has lacked the necessary level of rigor; consequently, the Department has accepted a higher degree of risk than typically would be accepted in implementing such systems.

19.128 We note that the Department established a Production Assurance Steering Committee and task force in the fall of 1995 to develop and oversee implementation of a new testing and quality assurance model for systems development projects. At the end of our audit, the Committee's work was still under way.

19.129 Revenue Canada should adhere to generally followed standards in the area of system quality assurance, problem resolution and management of change when developing and implementing key systems supporting the Child Tax Benefit and GST Credit programs and other similar systems.

Department's response: The discipline of testing in systems development is an exercise in risk management. When implementation dates must be met, Revenue Canada manages risk by deferring functionality that is not performing satisfactorily or immediately required. The final measure of testing success is the relative severity of the defects that are detected after production, and the proficiency with which they are handled and corrected. By this measure

and by industry norms, these projects were successful.

Information to Parliament and Other Stakeholders

Neither program is a priority for evaluation

19.130 In previous reports we have stressed the importance of periodic evaluation of all major government programs to determine whether they continue to be relevant, whether they are meeting intended objectives in a cost-effective way, and whether they are having any unintended consequences. We have expressed concern that program evaluation activities in some government departments do not receive sufficient priority.

19.131 Although the Child Tax Benefit Program has been in place since 1993 and the GST Credit Program since 1990, and despite the fact that these programs are among the largest federal social benefit programs targeted toward low- and modest-income families, neither program's performance has been evaluated against program objectives. Nor are there any plans for the next several years to conduct such evaluations. Our concern is heightened further because a framework for evaluation has not been defined or clarified for either program.

19.132 The Department of Finance is responsible for policy-related analyses of the Child Tax Benefit and GST Credit programs. Finance has indicated that neither of these programs is scheduled for evaluation in its current three-year evaluation plan.

19.133 The stated policy objectives for the Child Tax Benefit Program include simplicity, fairness, responsiveness, effectiveness and efficiency. The stated

policy objective of the GST Credit Program is to provide relief from the goods and services tax for families with low and modest incomes. There are a number of features in the structure of the two programs that are similar — such as the threshold for benefit phase-out, targeting low- and modest-income families, supplementing basic benefits and determining entitlements using family net income as a measure of well-being — that may warrant a combined evaluation.

19.134 In view of their social and financial significance, we are concerned that it may take many more years before Parliament learns of the extent to which the programs are meeting their intended objectives. Further, in the event that a decision is made to conduct such evaluations, the Department of Finance may not have the necessary information for the required analysis because a framework for evaluation has yet to be established for either program.

19.135 The Department of Finance should establish a framework for evaluating the Child Tax Benefit and GST Credit programs and ensure that the necessary information will be available when a decision is made to undertake an evaluation.

Finance's response: The Department of Finance will establish an evaluation framework for these credits and review the priority of evaluating them in relation to other evaluation topics.

Little accounting to Parliament for program performance and administration

19.136 Parliament receives very little information on either the results of the Child Tax Benefit and GST Credit programs or Revenue Canada's performance and priorities in administering these programs. Although the two programs are key components of

In view of their social and financial significance, we are concerned that it may take many more years before Parliament learns of the extent to which the programs are meeting their intended objectives.

the Department's income redistribution line of business, much less information is reported for this line of business than for the Department's other lines of business. While some information about the programs is reported in Part III of the Estimates, the Public Accounts of Canada and Tax Statistics on Individuals, the information is fragmented and none of the sources provides a complete and accurate picture of program performance, which weakens the Department's ability to account for actual results.

19.137 For example, the information on the Child Tax Benefit and GST Credit programs provided in Part III of the Estimates is limited to general information and basic statistics on the volumes of payments and recipients. Also, most of the information provided about these programs served primarily to announce that the function of determining eligibility for child tax benefits was being transferred from HRDC to Revenue Canada. Part III does not indicate plans to establish standards of services for these programs; nor, in the absence of plans, does it report on the programs' performance in key areas. Nor does it elaborate on priorities for the administration of these programs.

19.138 Revenue Canada should report to Parliament periodically on overall performance in administering the Child Tax Benefit and GST Credit programs. Information should also include relevant details on program plans, priorities and initiatives.

Department's response: In the context of the Treasury Board's Improved Reporting to Parliament project, Revenue Canada will review the information provided to parliamentarians.

Conclusion

19.139 Overall, our audit revealed that the GST Credit and Child Tax Benefit programs were launched on time and generally with success — a significant challenge in view of the short lead times available to meet statutory deadlines. Since the launches, millions of Canadians have been receiving their monthly or quarterly benefits. Nevertheless, we found that the Department's performance in serving program clients can be substantially improved in two key areas: clients experience significant difficulty in accessing the Department by phone and they also experience long delays in getting their child tax benefit applications processed. We also noted that the Department has not been measuring the take-up of either program. This was also the case with HRDC while it shared responsibility for administering child tax benefits, until August 1995. Without measures of program take-up it is unclear to what extent these key federal social programs, targeted primarily to families with low and modest incomes, are in fact reaching all those entitled to receive them.

19.140 Our audit also revealed a number of matters that require immediate attention in the areas of verification and enforcement and the processing of child tax benefits and GST credits. We concluded that Revenue Canada's control environment requires significant strengthening, to ensure equitable program delivery and to safeguard the public purse from significant losses. The Department has not been monitoring program results on an overall basis to ensure that aggregate statistics on key program variables, such as births and deaths of enrolled children, compare reasonably well with benchmark statistics on the same variables. Our own analysis of program statistics against independent

data on these variables suggests potentially serious problems that require urgent attention, at least with respect to child tax benefits. The implications for GST credits are unknown because we were unable to do a comparable analysis: the Department maintains only limited information on program participation and suitable third-party data were not available. However, we believe that the risks with GST credits are higher in many respects than with child tax benefits.

19.141 We also found that Revenue Canada accepted a high level of risk in not adhering to certain aspects of generally followed practices when it developed new systems to support the two programs. We also observed flaws in the tabulation of some key program statistics meant for use

by not only the Department but also a number of key stakeholders. As a result, stakeholders may not be well served and the Department's ability to monitor program performance and identify problem areas is severely weakened.

19.142 We note the absence of plans for any policy-related evaluations of either program by the Department of Finance. Consequently, it may take several years before Parliament learns of the extent to which these key federal social transfer programs are meeting their intended objectives.

19.143 Revenue Canada informs us that it has a number of initiatives under way to improve its administration of the programs. We have noted some of these initiatives in this report.



About the Audit

Audit Scope

Objectives

Our overall objective for this audit was to provide Parliament with information on:

- the level of GST credits and child tax benefits being provided through the tax system and information on the extent to which all those eligible for the benefits are receiving them;
- the adequacy of controls to protect the Crown from unnecessary losses and to report any significant deficiency in program delivery and/or controls;
- the efficiency of the Department's administration of the GST Credit and Child Tax Benefit programs;
- the systems in place for monitoring and evaluating both programs; and
- the quality of information reported to Parliament on the administration and performance of the programs.

Scope

In keeping with the overall objective, we focussed on the facilitation, verification and enforcement aspects of the programs. We looked at the procedures and practices the Department uses to make Canadians aware of the GST credit and child tax benefits; the systems and methods used to process applications and determine eligibility and entitlements; and the controls for detecting and preventing non-compliance. We compared key departmental statistics on enrolments with benchmark information from independent sources, following up on significant discrepancies with more detailed analysis of the data to understand the potential causes and implications. This exercise was not possible for the GST Credit Program since the Department maintains only limited program statistics, and we were unable to locate suitable third-party data for comparison purposes.

We did our audit work at Revenue Canada's headquarters in Ottawa, five regional offices, five tax centres and seven tax services offices across Canada. In addition, we interviewed officials at HRDC and the Department of Finance to learn about their respective roles in administering and evaluating either child tax benefits or GST credits. We also met with U.S. officials from the Internal Revenue Service, the Office of Tax Analysis, the General Accounting Office and with officials from provincial social assistance and/or vital statistics agencies in Newfoundland, Quebec, Ontario, Alberta, and British Columbia to obtain a perspective on overall trends in social assistance administration and specific information on experiences, client profiles and current initiatives.

Criteria

- In administering new programs such as Child Tax Benefit and GST Credit through the tax system, the Department should prepare and adhere to an appropriate implementation strategy in accordance with its legislative mandate.
- The Child Tax Benefit and GST Credit programs should be supported by an effective and efficient facilitation process to ensure that all eligible individuals both understand their rights to these social benefits and are provided with means to apply for and receive them.

- Benefits under the Child Tax Benefit and GST Credit programs should be delivered promptly and be responsive to changes in recipients' status at least cost to the government, while providing for the fair and equitable treatment of recipients.
- The administration of the Child Tax Benefit and GST Credit programs should include an appropriate enforcement strategy.
- An adequate system of internal controls should be in place to ensure the authenticity of transactions; the reliability and completeness of key databases; and the processing of eligibility, entitlements, adjustments and elections in accordance with legislative provisions.
- The administration of the Child Tax Benefit and GST Credit programs should be carried out with efficient systems and procedures. The Department should search for and implement, to the extent feasible, cost-effective and innovative administrative practices.
- There should be a framework for monitoring and evaluating the Child Tax Benefit and GST Credit programs, and procedures for collecting and reporting appropriate performance information to decision makers.
- Parliament should be kept informed of the cost, results and departmental performance in administering the Child Tax Benefit and GST Credit programs.

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Revenue Canada provided the action plan below with its response to our recommendations.

THE DEPARTMENT'S ACTION PLAN

In 1995, the Department created a separate headquarters division for benefit programs to ensure equitable program delivery and strengthen controls over these important activities. A number of specific measures are under way which will help ensure that all Canadians receive their correct entitlement.

The Department will build on its tradition of client consultation and balanced service and enforcement by:

1) Using survey and sampling techniques to determine

- the take-up rates for child tax benefits and GST credits;
- the level of awareness of entitlements and obligations under child tax benefits and GST credits;
- the degree to which related information needs are met; and
- compliance levels and potential areas of non-compliance.

By June, 1997 the Department intends to have in place

- profiles of the information and service needs of child tax benefits and GST credit clients;
- compliance profiles to sustain effective, targeted verification and enforcement activities; and
- communications strategies for reaching all potential clients.

2) Developing quality assurance and performance measurement programs which are specifically tailored to its benefit programs, to ensure and report on the extent to which

- client service and processing standards are clearly communicated and met;
- processing systems are added or modified in accordance with approved practices;
- risks and vulnerabilities are identified, quantified and addressed; and
- processing systems and work methods consistently provide accurate results and decisions.

Processing standards will be in place and monitored by December, 1996. A single consolidated production assurance model and a transition plan will be in place by the fall of 1996. A formal quality assurance strategy, including performance measurement standards, will be in place for the 1997–1998 fiscal year.

3) Redesigning and improving telephone enquiries systems to

- facilitate the definition and achievement of appropriate service standards, at an affordable cost; and
- provide targeted services which meet identified clients' needs.

An extensive re-engineering of departmental telephone systems was initiated in 1995. Extensive client consultation and testing has been undertaken. In 1997, Phase 1 will be implemented in three major cities handling 40% of the call volumes.

4) Enhancing its enforcement programs through compliance research and other measures, such as

- compliance measurement samples;
- directed statistical samples to quantify identified "problem areas"; and
- negotiating effective, economical exchanges of key information with the provinces.

These activities, including provincial negotiations, will be ongoing. The initial results will be used to refine targeted, effective verification and enforcement procedures for the 1997–98 fiscal year.

5) Monitoring overall performance of major benefit programs by:

- developing and maintaining appropriate statistical measures which meet the needs of Revenue Canada, Finance, and other stakeholders;
- using data from Statistics Canada and other external sources to establish baseline indicators for the evaluation of key programs; and
- using client consultation and external data to quantify "take-up" rates, client errors or fraud, identify appropriate departmental responses and evaluate their effectiveness.

Significant improvements to the statistical reporting framework will be made before April 1997. Baseline indicators will be further developed as data from the 1996 census become available.

Chapter 20

Revenue Canada

Creating One Revenue Canada:
The Administrative Consolidation of
Customs and Excise and Taxation

The audit work reported in this chapter was conducted in accordance with the legislative mandate, policies and practices of the Office of the Auditor General. These policies and practices embrace the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

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Assistant Auditor General: Shahid Minto
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Revenue Canada

Creating One Revenue Canada: The Administrative Consolidation of Customs and Excise and Taxation

Main Points

20.1 Beginning in 1992, the formerly separate departments of Customs and Excise and Taxation were brought together into one department, Revenue Canada. Our audit of the “administrative consolidation” of Revenue Canada selected three aspects on which to judge success:

- corporate management of administrative consolidation;
- the introduction of a single business number for each business client; and
- the opening of “business window” service sites across the country.

20.2 Our examination found there were good practices common to the three aspects that helped make their implementation successful. These included:

- a clear overall vision and principles to guide the process;
- the commitment and involvement of senior management;
- good communication with stakeholders and employees at all levels; and
- good project management.

These practices were particularly important given the special difficulties involved in administrative consolidation, including an uncertain legislative environment and the challenge of combining different work cultures.

20.3 A number of areas still require improvement, including levels of service and classification of staff in the business window activity. The business number project also faces a major challenge in January 1997, when all remaining businesses will be required to convert to the new system.

20.4 Administrative consolidation has been and continues to be a challenging task and, for the most part, it has been well managed by the Department. On the whole, with respect to the aspects we examined, we conclude that administrative consolidation is establishing a solid foundation for:

- streamlined operations;
- improved service; and
- enhanced compliance.

It has also made possible new ways of using and integrating information, both internally and in co-operation with other levels of government.

Introduction

20.5 Revenue Canada is the federal government's second-largest organization, with 39,000 full-time equivalents. The Department assesses and collects revenues for the federal government and nine provincial governments, administers tax credit programs, effects social and economic payments through the tax system, enforces compliance with trade policies, and protects the integrity of Canadian borders in the international movement of goods, services and people.

20.6 What is now one department was formerly two separate organizations, Revenue Canada-Customs and Excise and Revenue Canada-Taxation. The administrative consolidation of the two organizations started with the appointment of a single person to act as Deputy Minister for both departments, effective 1 October 1992. On 12 May 1994 the *Department of National Revenue Act* was amended to permit the administrative consolidation.

20.7 Administrative consolidation began at a time of rapid change. Increasingly, the public was demanding open, fair, accountable and productive government, placing more emphasis on values and rights. Technological change was accelerating, making an interconnected, integrated, electronic-based revenue department not only a possibility but an expectation.

20.8 In addition, funding limits were placing added pressure on existing activities and on the resources available to make needed changes. There was also an increasing awareness of the need to collect money owed to the government by the underground economy; the government was looking to Revenue Canada for help in reducing the deficit.

20.9 The overall objectives of administrative consolidation were to:

- develop a more effective, consistent and harmonized approach to the delivery of the Department's legislative mandate;
- enhance client service;
- create substantial opportunities for efficiency gains through a more streamlined organization, shared resources and elimination of duplication;
- manage the intellectual and knowledge assets of the Department to the best advantage of the government and its clients;
- strengthen the Department's contribution to national competitiveness;
- install an electronic infrastructure that would allow the Department to act as a prime catalyst of electronic commerce in Canada, thereby contributing to national prosperity;
- create a model organization that would be greater than the sum of its current component parts and capable of adapting rapidly to accommodate changing needs and priorities; and
- build a capable and committed workforce sharing a common vision of service excellence.

20.10 As administrative consolidation proceeded, it became a banner under which ongoing departmental initiatives were included (see Exhibit 20.1). Two of these initiatives, the 1992 six-point plan for Customs and the eight-point plan for Goods and Services Tax (GST) and Taxation, were to increase the focus on clients in departmental operations. Other initiatives with the same goal included simplifying the individual tax return, streamlining the appeals process, and opening public counter services in taxation centres.

Focus of our audit

20.11 As Revenue Canada's efforts to implement administrative consolidation

**One Deputy Minister
was appointed for both
organizations in
October 1992.**

Administrative consolidation “was like changing the wiring with the lights on.”

are well under way, we concluded that this was an opportune time to address the topic.

20.12 Administrative consolidation has involved more than 50 separate projects at headquarters and in the regions. It required extensive changes in organizations, values, systems, practices, plans and directions. Our audit focussed on three major aspects:

- the Department’s steering of the whole consolidation process at the corporate level;
- introduction of a single business number, which facilitated the consolidation of its registration and information resources; and

- opening of business window service sites, which entailed the consolidation of human resources from different work cultures.

20.13 Further details about our objectives, scope and criteria can be found at the end of the chapter in the section **About the Audit**. We hope that the findings of this audit will be useful to other departments and agencies undertaking similar consolidation of their resources.

Observations

The Operational Context

Implementation was constrained by the operating environment

20.14 Revenue Canada was faced with two constraining factors in its administrative consolidation. First, it had to continue operating while it was consolidating. It had to answer enquiries, assess tax returns, process travellers and goods entering Canada, collect revenue, and audit taxpayers. As one official said, “It was like changing the wiring with the lights on.”

20.15 The second constraint was the new reality of downsizing. For the last few years Revenue Canada, like other government departments, has been subject to decreases in its ongoing operating budgets to support expenditure reduction. At the same time, the government has given the Department new measures to implement, which has kept the overall budget relatively constant. Also, as a part of Program Review, departments have had to look at their programs and decide which ones to continue. No Revenue Canada programs were dropped in that exercise. The Department is now undergoing a re-engineering of its major operations to help it meet the imposed

Exhibit 20.1
Chronology of Key Events

25 February 1992	Budget announced the move to a single registration number for businesses
16 September 1992	Minister announced the six-point plan for Customs
1 October 1992	A single individual was appointed as Deputy Minister of both Customs and Excise, and Taxation
25 November 1992	Minister announced the eight-point plan for GST and Taxation
25 June 1993	Government announced its proposal to create a Department of Public Security
4 November 1993	Government announced that it was dropping the idea of a Department of Public Security
24 January 1994	Bill to amend the <i>Department of National Revenue Act</i> was tabled in Parliament
12 May 1994	Amendment to the <i>Department of National Revenue Act</i> received royal assent
May 1994	Pilot opened for business number registration and business window
February – April 1995	Department phased in the national implementation of business number registration and business windows
31 December 1996	Voluntary conversion to the business number will end

reductions. Further, in 1994 the government stated that it wanted to reduce the space it occupied, by a target of 10 percent over five years. As of 1996, Revenue Canada has reduced its space by approximately 7 percent.

20.16 These factors limited the human and financial resources that could be allocated to consolidation projects. In addition, with these various factors at work, the Department could not attribute reductions in its operating costs and space to administrative consolidation alone.

Administrative consolidation in an uncertain legislative environment

20.17 Revenue Canada had to be brought together legally as well as operationally. Two factors resulted in delays and uncertainty in the consolidation of Customs and Excise and Taxation into one department: the amendment of the *Department of National Revenue Act*, and the issues surrounding a proposal for a Department of Public Security.

20.18 The *Department of National Revenue Act* is the enabling authority for both of the former departments, Revenue Canada-Customs and Excise and Revenue Canada-Taxation. That Act authorized a separate deputy minister for each of the two departments, and required them both to report to the Minister of National Revenue.

20.19 The departments needed legal authority to consolidate. One existing authority that might be expected to apply could not be used, because it applied to a transfer of powers from one minister to another; in this case there was only one minister. Nor could the *Department of National Revenue Act* be left as it was, because it stipulated that there were two deputy ministers. Revenue Canada had to

request an amendment to the *Department of National Revenue Act*.

20.20 Circumstances intervened to slow the amendment. Shortly after the October 1992 appointment of a single individual to act as Deputy Minister for both organizations, the Department identified the need to change the founding Act. It had to be placed on the parliamentary agenda, but Parliament did not sit from the end of June 1993 to January 1994 because of the summer recess, an election and a change of government. Once Parliament resumed sitting, Revenue Canada acted quickly. In fact, the amendment to the *Department of National Revenue Act* was the first bill tabled in the new Parliament, in January 1994. It received royal assent on 12 May 1994.

20.21 Until the Act was amended, two key components of the consolidation were on hold: Revenue Canada could not finalize its new organizational design; nor could it appoint people to positions. This left staff feeling uncertain about their future.

20.22 The second cause of delay and uncertainty resulted from a proposal to create a Department of Public Security. On 25 June 1993 the government announced it was considering the creation of a Department of Public Security that would include Customs border operations. The Public Security issue had two main effects. First, it further delayed the finalization of the organizational design: departmental staff had to develop plans for transferring operations and resources to Public Security. Second, it upset staff. The union representing Customs staff favoured this direction; it was concerned about a decline in border protection under a consolidated Revenue Canada. Following the election, the new government announced on 4 November 1993 that it had dropped the idea of a

Two factors resulted in delays and uncertainty.

**The vision of
administrative
consolidation reflects
government priorities.**

Department of Public Security. Union concern continued, however.

Steering the Process at the Corporate Level

20.23 Steering the consolidation process toward the desired objectives was a vital part of bringing together two separate departments; management's goal was to ensure the overall success of the consolidation (see Exhibit 20.2, which was prepared by Revenue Canada)

A discernible vision for administrative consolidation

20.24 Early in the consolidation process, senior management articulated a vision of what Revenue Canada would be like with the two departments combined into one. The vision contained many elements, some general and others more specific. For example, it envisioned Revenue Canada as a single entity that would conduct business in new ways and treat clients as clients of the whole Department. It also saw improved service for clients through the greater use of technology and through access to all programs by "single windows". The two major initiatives examined by this audit, the business number and business window, were consistent with this vision.

20.25 Senior management communicated its vision in different ways, both internally and externally. Managers learned about the vision from a news release and then, in more depth, from documents and in speeches at regional and headquarters conferences in early 1993. Parliament and the public learned of the consolidation from news releases, Budgets, the Estimates and departmental presentations. Early messages have been repeated and different aspects have been reinforced over the years.

20.26 The vision of administrative consolidation clearly reflects government priorities announced before and after the October 1992 appointment of a single Deputy Minister for Revenue Canada. Both the vision and the priorities, for example, emphasize improving and clustering client services; streamlining and consolidating operations; lowering costs by reducing overlap and duplication; applying appropriate information technology; and integrating databases.

The Department developed objectives and principles of consolidation

20.27 The Department's overall vision provided sufficient detail to guide the initial planning and implementation of the consolidation of Customs and Excise and Taxation. Senior management did not prescribe the details; it allowed those

Exhibit 20.2

Revenue Canada's Rationale for Administrative Consolidation

- Improved administration of Canada's tax regime, through harmonized fairness, appeals and redress provisions.
- Direct savings and cost reductions — both for the Department and its clients — through economies of scale, and the elimination of overlap and duplication.
- Improved client service as a result of single window access to integrated services, simplified administrative requirements, and improved responsiveness.
- Improved program effectiveness, including strengthened compliance capabilities.
- Enhanced career and developmental opportunities for Revenue Canada employees, through the sharing of skills and expertise, and collaboration on re-engineering initiatives.
- Effectiveness platform for managing future change, including moving toward a new revenue and border administration.

Source: Revenue Canada

working on the various projects to develop the details to attain the vision.

20.28 There is no single document or master plan that contains all the elements of a plan to consolidate Revenue Canada. Planning was an iterative process. Detailed objectives and guiding principles were developed for the consolidation process. Senior management shared them with managers from across the Department, and defined a framework for projects. Some of the projects were at a corporate level — for example, revising the departmental mission, designing an organizational structure and defining a human resource strategy. Other projects were related to specific activities, such as setting up single access points for client enquiries and integrating accounting. Ongoing initiatives, such as the introduction of the single business number, were added to the framework.

20.29 Senior management assigned leaders for each project. It freed up departmental people to work full time or part time on administrative consolidation projects. Where appropriate, it included both headquarters and field office staff on the project teams.

20.30 Many of the projects were interrelated and could not operate in isolation. The Department formed a committee of the project leaders to keep each other up-to-date on the progress of projects. In some cases, project teams worked even more closely.

20.31 Management did not set a final deadline for administrative consolidation. It wanted to take the time to do it right. Some areas could be consolidated quickly. Other areas would require extensive modification and take years to complete. This was a wise move, given the delays encountered (mentioned in paragraph 20.17).

Senior management made it a priority to keep staff informed

20.32 From the beginning, management realized that it was critical to communicate its vision and its progress to its employees. Senior management discussed employee communication in its first committee meeting following the October 1992 appointment of the single Deputy Minister. The Department made advising staff a guiding principle of the consolidation process. A large part of the communications and consultation strategy, approved in early 1993, dealt with employees. The strategy put the onus on managers to keep staff informed.

20.33 The Department used numerous means to communicate with its employees about administrative consolidation. All employees received memoranda from the Deputy Minister and regular issues of the departmental newsletter, which contained information on senior management, organizational changes and other consolidation projects. Managers both in headquarters and in the regions attended conferences and information sessions to hear project team leaders and to discuss consolidation issues in groups.

20.34 Besides providing information, management wanted feedback from employees. Branch and regional heads appointed administrative consolidation co-ordinators to help information flow between the branch or region and those working on consolidation projects at headquarters. Senior management set up a telephone line so that staff could call for information and provide feedback; however, few calls were received. We were told that more questions and feedback were conveyed directly to the project teams. Following the information sessions, managers discussed issues raised with their staff and sent in their comments on the issues. Some managers complained

Detailed objectives and guiding principles were developed for the consolidation process.

Managers and staff said, “You cannot communicate too much.”

about the short time allowed for this exercise.

20.35 Managers and staff told us time and again that there cannot be too much communication about changes of the magnitude of those involved in administrative consolidation. While some staff felt overloaded with information, others felt they had not received enough. Information takes a long time to sink in: some staff, for instance, did not realize that the implementation of the consolidated organization was being slowed by the wait for a legislative amendment.

20.36 Communicating with unions was one of management’s guiding principles for the consolidation process. Senior management meets formally with the national executives of the unions about twice each year to discuss issues of mutual importance. Since 1992, departmental managers have presented information and documents on administrative consolidation to discuss at these union-management meetings. In addition, there have been a number of informal meetings and presentations each year. While there has been concern about the effect on staff of consolidating Customs and Excise with Taxation, management’s relationship with the various staff unions has been good.

Clients were informed about benefits of administrative consolidation

20.37 Revenue Canada operates on a philosophy of voluntary compliance and open communication with its clients. This philosophy is clearly reflected in documents developed for the consolidation of the Department. For example, communication with clients is one of Revenue Canada’s guiding principles for consolidation, and forms a major part of its communications and

consultation strategy. The strategy defines its target audiences; specifies that messages are to be tailored to the interests of the audience; and requires the continued use of existing formal and informal relationships with client groups. This strategy was distributed to managers to use in communicating with parties outside the Department.

20.38 The Department spread its messages about administrative consolidation by various means. The Minister and Deputy Minister spoke about the benefits of administrative consolidation at meetings and conferences of client organizations. The Minister wrote to mayors of border cities and to members of Parliament to ease concern about border protection. The Department reported in Part III of the Estimates and made presentations to parliamentary committees on the benefits and status of its consolidation. It discussed administrative consolidation at various advisory committee meetings; these meetings were a part of its regular consultations with clients.

Senior management demonstrated ownership and involvement

20.39 Employees of Revenue Canada whom we interviewed are convinced that their senior management is committed to a consolidated Revenue Canada. This commitment was continuously demonstrated by management’s attendance at employee briefings and in speeches, memoranda and articles in departmental newsletters.

20.40 Senior managers made consolidation a priority. They worked together to decide on the significant consolidation matters. Initially, the 16 senior managers from headquarters formed a special committee that met periodically. The regional heads were not initially on this committee because of

their number; it would have been unwieldy to operate the committee with an additional 23 people — the heads of all the Customs, Excise and Taxation regional offices. When the organizational structure was finalized in 1994, all 18 heads of the headquarters branches and regional offices became the new senior management committee of Revenue Canada. This committee went on to deal with any outstanding administrative consolidation matters.

20.41 The senior management committee, however, could not run the process of administrative consolidation alone. Help came from two sources: a secretariat and project teams. The secretariat ran the day-to-day affairs and co-ordinated and monitored progress for the committee: it prepared documents, reviewed project reports, gave information to the senior management committee and asked the committee to make decisions. The project teams conducted and are still conducting the detailed work necessary to consolidate the Department.

The organizational design eliminated major duplication of functions

20.42 One of the goals of administrative consolidation was to eliminate duplication. Consolidation was a means to become more efficient, not necessarily to reduce staff.

20.43 As a rule, a certain amount of overlap and duplication can be eliminated when two organizations are brought together. Revenue Canada's corporate functions in headquarters are an illustration. In October 1992, each of the two departments had separate functions for human resources, communications, information technology, finance and administration. Combining these two sets of corporate functions into one was a logical first step to eliminating

duplication. The process was begun just after the 1992 appointment of the single Deputy Minister.

20.44 A more difficult task was to design the consolidated headquarters operating branches and field organization. This involved thousands of employees spread across the country, with separate operations for Customs, Excise and Taxation. After study, Revenue Canada decided to combine operations for income tax and commodity taxes, including GST, since they were so similar and dealt with essentially the same clients. This lengthy process started in 1994 and is still taking place both in headquarters and in field operations. When it is completed, there will be one tax services office in each field location, instead of two in some cases — reducing the number of offices from 75 to 51. The Department decided that headquarters operating branches should mirror the organization in field offices. The various operations that had been handled by the six headquarters branches of Customs, Excise and Taxation are now realigned into six Revenue Canada branches that reflect field operations (see Exhibit 20.3).

20.45 Further, instead of separate regional offices for Customs, Excise and Taxation, there is now one office handling all operations in each region. This has reduced the number of regional offices from 23 to 6.

20.46 In the consolidated Revenue Canada, Customs operations in headquarters and in field offices have not been combined with those of Excise and Taxation. The Department is currently undertaking a review of the organization of its Customs operations and is continuing the fundamental redesign of these operations announced in September 1992. However, Customs is sharing common corporate services such as

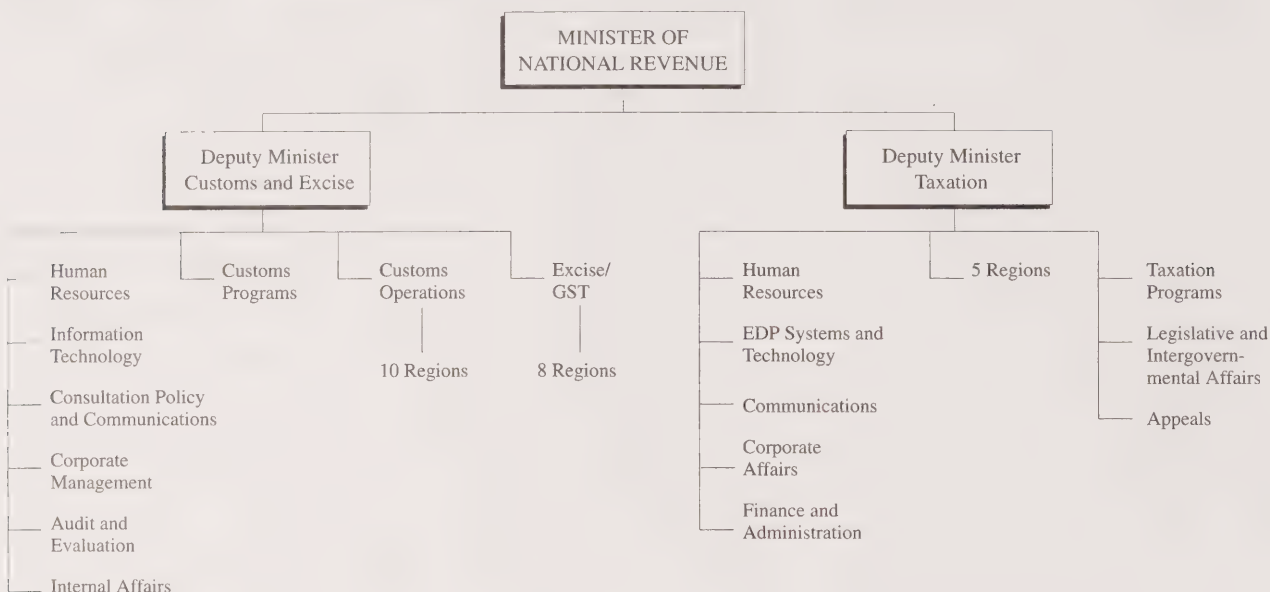
The senior management committee could not run the consolidation process alone.

Revenue Canada – Creating One Revenue Canada:
The Administrative Consolidation of Customs and Excise and Taxation

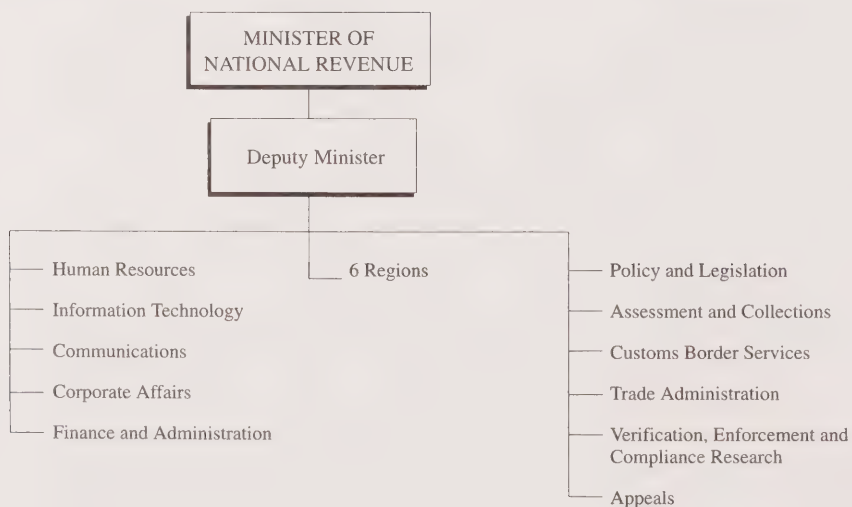
Exhibit 20.3

Change in the Organizational
Structure of Revenue Canada

1992 — BEFORE ADMINISTRATIVE CONSOLIDATION



1996 — AFTER ADMINISTRATIVE CONSOLIDATION



finance and administration with neighbouring tax services offices.

The Business Number

20.47 The business number is a unique business identifier designed to replace the multiple numbers that an estimated 2.4 million Canadian businesses now must have to deal with the federal government. The business number provides simplified, accessible and faster registration and information services to Revenue Canada's business clients. At the same time, it benefits the Department by reducing costs,

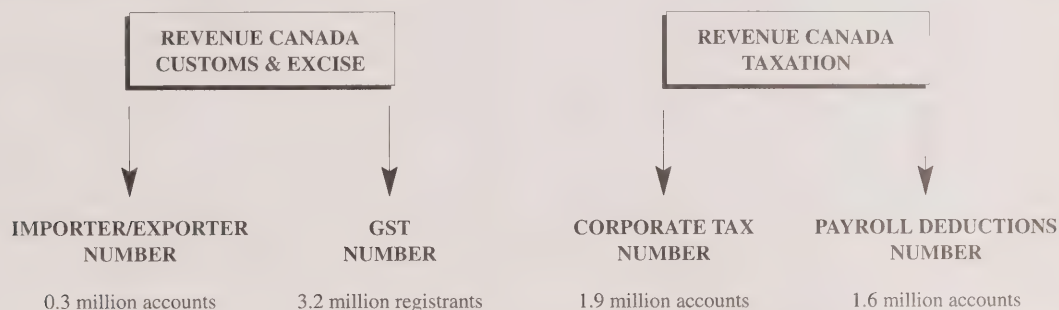
saving time and enhancing its revenue accounting and enforcement abilities. The business number also facilitates the sharing of information with other departments and levels of government.

20.48 Canadian businesses have long expressed their desire to simplify the way they deal with government. The business number addresses this concern by eliminating the need to register separately for four of Revenue Canada's lines of business (payroll deductions, goods and services tax, corporate tax, and import/export duties — see Exhibit 20.4).

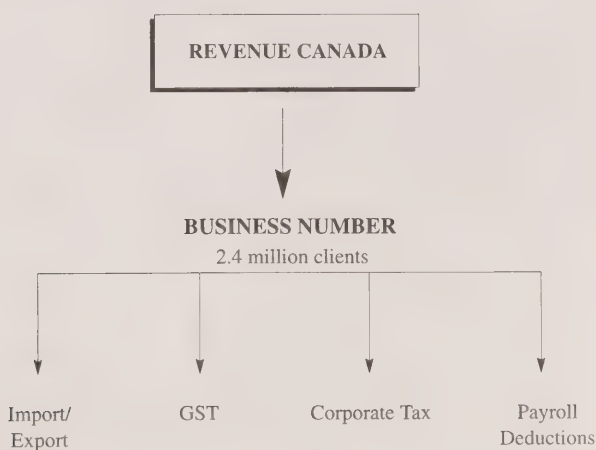
Exhibit 20.4

Impact of Business Number

1992 — BEFORE ADMINISTRATIVE CONSOLIDATION



1996 — AFTER ADMINISTRATIVE CONSOLIDATION



The business number
is a unique business
identifier.

Revenue Canada staff can now answer questions on basic account information about each of a business's several accounts through a single point of contact. If information about a business — such as its address — changes, one call is sufficient to update its accounts at Revenue Canada. The business number reduces the paperwork and time spent by business people who supply the information and by federal employees who collect and use it.

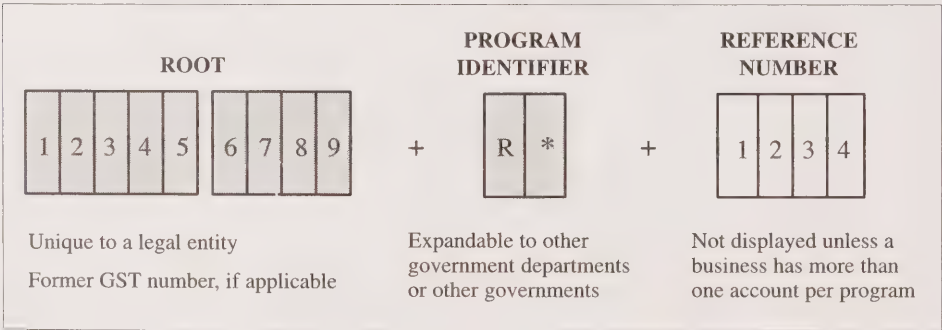
20.49 This concept was announced in the February 1992 Budget. A detailed proposal for the business number project was prepared by an interdepartmental working group. In September 1992, the project was transferred to Revenue Canada. When administrative consolidation was announced, it became clear that the business number's similar objectives would facilitate administrative consolidation. Business number registration began in 1994 as a pilot, and since April 1995 has been available to businesses across Canada. All new businesses registering in one of the four Revenue Canada lines of business receive a business number (see Exhibit 20.5). In response to requests from the business

community, existing businesses were given two years — until 31 December 1996 — to convert voluntarily to the new numbering system. After that date, conversion will be mandatory.

20.50 Broadly speaking, administrative consolidation is meant to improve both efficiency and organizational effectiveness. Improvements are to be realized through better use of physical, human and information resources. The business number uses information resources as a source of improved efficiency and effectiveness. It represents the key to better access and co-ordinated use of the automated business information possessed by the two former departments of Customs and Excise and Taxation.

20.51 Applying the business number concept requires information technology, but it is important not to confuse the concept with the technology. In this section of the chapter, we will talk about both, but it is the concept that is of more significant interest here. Having said that, it so happens that Revenue Canada did a very good job of developing the business number system. We want to acknowledge this as a significant accomplishment in its own right.

Exhibit 20.5
Business Number



R = Revenue Canada

* { P = Payroll Deductions
T = GST
C = Corporate
M = Import/Export

New possibilities for better management of information

20.52 If government can manage information resources more effectively, it can compensate for the loss of other resources due to restraint measures. It is this potential that makes the business number so interesting. Better management of information resources includes planning their acquisition and use, restructuring and consolidating, eliminating duplication and waste, and assigning new responsibilities. The government's traditional preoccupation with material assets is being overtaken by a concern with information and knowledge. What people and organizations know is becoming more important than what they have.

20.53 The business number is a flexible system that can be expanded to other Revenue Canada lines of business, for example, excise taxes. Equally important, it facilitates single-window services and the sharing of information among government departments. Departmental lines of business using the business number as their identifier can now share registration information easily, subject to legal constraints on sharing information. This has rarely been done in the past, due to the lack of a common identifier.

20.54 In 1994 the Treasury Board Secretariat, the central agency responsible for information technology standards across all federal government departments, cited the single business number in the *Blueprint for Renewing Government Services Using Information Technology*. The Secretariat sees the business number as an example of one-stop services that will reduce duplication and improve government operations. It also sees it as an example of delivering government services in a more useful way, using common collection and analysis, and sharing of information. In

1995 the Treasury Board ministers approved a plan to implement the Blueprint. The purpose of the plan was to allow for "improved services while significantly reducing costs through the accelerated implementation of the Single Window concept, supported by enabling information management and technology." The business number has now been incorporated into the Treasury Board Information Technology Standards.

20.55 Statistics Canada currently maintains a list of businesses to support its statistical programs. It has signed a protocol with Revenue Canada that provides Statistics Canada with business number registration records and provides Revenue Canada with "standard industrial classification" codes. Once implemented in March 1997, the system is expected to provide Statistics Canada with a more complete list of businesses, combined with consistent industrial codes. It will allow the agency to further minimize the surveying of businesses while improving the quality of its statistical output. For Revenue Canada, the protocol will permit the acquisition of consistent codes at lesser cost.

20.56 A desire to improve client service has prompted all levels of government to provide some form of "single window" service to reduce overlap and duplication. Revenue Canada and the Province of Ontario are now examining the use of automated workstations at which business users can register for both provincial and federal programs, using the business number as the common identifier. The registration process is only the first step, however. Other potential benefits of co-operative ventures with the provinces include shared federal and provincial information and computing resources, improved information and increased government efficiency. Lessons learned

What people know is becoming more important than what they have.

Use of the business number is the foundation for providing integrated services.

with Ontario are expected to be applied to other provinces adopting the business number.

A key milestone in managing information services

20.57 Implementation of the business number is a key milestone for both Revenue Canada and the federal government in the management of information services. This issue is of critical importance for modern organizations. The business number is the first major project visible to the public that demonstrates Revenue Canada's commitment to providing services in an integrated way. Because the system allows auditors and administrators to access a complete and common body of information, it should have longer-term compliance benefits. Implementation of the business number is the foundation from which a broader range of integrated services can be developed in Revenue Canada, the federal government and the provinces.

A strategic investment

20.58 Revenue Canada viewed the business number project as a strategic investment, and believed that its benefits would flow from the elimination of duplicate data collection and from subsequent projects, notably the integration of accounting systems and improved sharing of information. Revenue Canada funded this project internally and used the budget process to obtain Treasury Board approval for the project. The approved budget of \$54.4 million was complete and comprehensive. The project appears to be under budget.

A technically complicated system involving new technologies

20.59 The heart of the business number project is the creation of a new

information technology system to accept the registration information, using the business number as a common identifier. The business number system is a very large and complex project. It incorporates new technologies — like reusable code, database and client server technologies — that move Revenue Canada into the future. The business number system links the existing programs, but also is flexible enough to allow others to be added later. The fact that the programs being linked were running at different data centres and using different technologies added significantly to the project's complexity.

Good communications were critical to success

20.60 Recognizing that successful implementation of the business number depended on communication, co-operation and commitment, the project team created a network to ensure that those concerned were kept informed. Representatives from all key areas within Revenue Canada attended meetings at which they received updates on the progress of the business number project and offered expert advice on issues that affected their areas. A representative from each of the six Revenue Canada regions and a local co-ordinator from each affected office were selected to ensure that information flowed quickly and efficiently to and from the field offices.

20.61 Information about the business number was communicated in many different ways. There were staff briefings, articles in all the departmental newsletters, a travelling roadshow visiting the regions, and e-mail open lines for information and questions. Members of the project teams travelled to Revenue Canada offices delivering information sessions. Articles were written for internal and external publications, and professional associations were briefed. Each affected

business was mailed information about the business number.

The project was split into manageable components

20.62 Due to the magnitude of the changes that the business number project would bring, it was decided to break the project into smaller, more manageable pieces: a pilot phase, national implementation, and future expansion and enhancements. The eight-city pilot identified the need for significant revisions to the training methodology and training approach, averting major problems that could have occurred had national implementation started without benefit of the pilot.

20.63 The implementation dates were phased in across Canada to ensure a smooth transition. This allowed headquarters production staff to be available in field offices when each came on-line. An evaluation of the pilot projects concluded that about 70 percent of the business clients invited to convert believed that the business number was a positive change, offering significant improvement in business and government efficiency. The pilot and national implementation caused almost no disruption to continuing operations.

20.64 Some initially slow service during the pilot and national implementation was quickly corrected. The reliability of the system continually improved during the pilot and national implementation phases, as well as during subsequent enhancements. This phased approach was successful in bringing together, in a tight timeframe, four very different programs, which used different technologies and database structures and had different staff cultures.

Project was well managed

20.65 The business number was the first project involving four major business programs in the new consolidated Revenue Canada. This made the management process very difficult. Dealing with the many management issues added greatly to the complexity of project management.

20.66 Senior management established separate user and information technology project teams, led by experienced project managers who were given the authority they needed. The information technology project team was strongly results-oriented and had the advice of experts assigned to review the project. There were regular committee meetings of both project teams, chaired by senior management, so issues tended to be resolved between the meeting dates. This approach forced people to talk and work together. The user project team peaked at 25 people and there were more than 50 on the information technology project team, but the implementation of the business number could not have occurred without the involvement of hundreds of other individuals. Another key factor was that the project teams were made up of people from both of the former departments, which added credibility to the whole process.

20.67 The business number project made good use of contractors. Revenue Canada maintained ownership and control of the project and used outside contractors as support staff and trainers. The Department's approach was to train its staff in the use of the new technologies rather than relying entirely on contractors. This approach was good for morale, staff development and retention of corporate memory. It also made good use of project management tools.

The business number was phased in across Canada.

**Independent review
provided timely advice.**

20.68 The project was adequately resourced and staffed, although there were some minor delays caused by a shortage of qualified programmers. Future plans that incorporate new technologies need to be based on the availability of trained staff or contractors.

Testing was inadequate

20.69 Testing of the business number system before implementation was done under severe time pressure due to in-house deadlines; thus, all planned tests were not completed. System problems appeared in the pilot and, to a lesser extent, during national implementation. Testing was late and fragmented among the various lines of business, and different practices and tools were used. Both of the former departments lacked a formal quality assurance and control function. However, in the fall of 1995, Revenue Canada pulled together the various testing groups as part of the administrative consolidation process. In April 1996, an internal task force was formed to review current practices and to recommend a single consolidated production assurance model, including process, policies, tools and techniques.

Effective internal and external review process

20.70 Internal audit and other peer groups were continually involved during the development of the project. Internal audit participated in the project from the start and provided an ongoing review throughout its development. Internal audit's advice was timely, and the project team found its suggestions very useful. Several independent organizations were also brought in throughout the project to review various technological aspects. Their studies indicated that the project was well managed and systems development was efficient. An external system review group was set up by senior

management to review the system's design and its use of computer resources. Its report was received before the end of the design phase so it was possible to make the required changes early.

Completing the conversion process

20.71 As of 30 April 1996, more than 875,000 of an estimated 2.1 million existing businesses had converted to the business number system. Revenue Canada expects that by the 31 December 1996 deadline, 25 percent will still remain to be converted. In addition, over 300,000 new businesses have registered for business numbers.

20.72 There is a risk, because 60 percent of companies had failed to convert as of 30 April 1996, that there will be an overload of work in January 1997. However, the Department is confident that it can handle the situation. The field offices say that they have adequate resources and plans to deal with the work. The problem is not the business number system, but rather the data in the existing program databases. Revenue Canada is currently cleaning up these databases to eliminate duplicate and unused accounts. Starting 1 January 1997, it will print out possible account matches for all remaining unconverted clients so that staff can attempt to verify them. If no contact can be made with the client, a best guess will be made and a request for confirmation mailed. The end result is expected to be a more accurate registry than exists in the current programs.

20.73 The business number has the potential to improve Revenue Canada's service and enforcement capabilities. However, these results are not guaranteed if the changes required to fully implement the business number concept are not carried out properly. At this point, we can say only that the Department is off to a good start. The key to future success lies

**Business numbers
should improve
service and
enforcement.**

in managing the risks that present themselves along the way.

The Business Window

20.74 The business window provides businesses with one point of contact for dealing with Revenue Canada, either over the counter, by telephone or in writing (see Exhibit 20.6). Using a business window, businesses can open Revenue Canada accounts, make enquires and obtain publications and information from the same location, at the same time. The business window concept, along with the business number, provides a good foundation for better, faster and more efficient service to business. It is expected to help Canadian businesses be more

competitive, and to reduce costs to both business and government by minimizing overlap, duplication and paperwork.

20.75 Initially, the business window includes Revenue Canada's four main lines of business: payroll deductions, the goods and services tax, corporate income tax and import/export duties. By October 1995, Revenue Canada had introduced business windows in 48 offices across Canada. They include a total of more than 400 staff and handle an estimated 3.8 million business enquires per year, most of which are telephone enquiries.

20.76 The consolidation of GST and Taxation staff was a major challenge. The organizations had very different organizational structures, cultures,

The business window provides "one-stop" shopping.

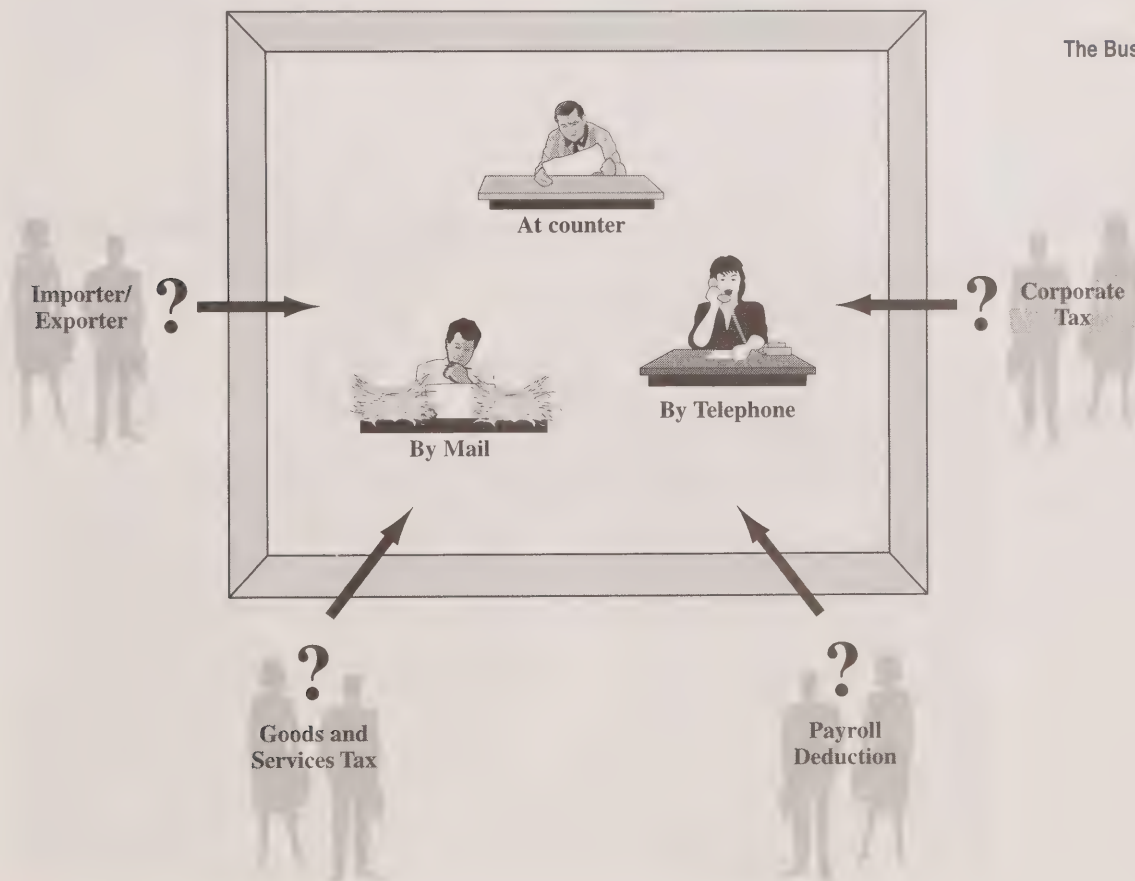


Exhibit 20.6

The Business Window

computer systems, compliance policies, levels of job classification and levels of authority. The challenge was to bring together people who had not worked closely in the past.

Good planning and project management

20.77 The business window was piloted along with the business number and then phased in, by region, across the country. In the national implementation stage the staff were co-located, a lesson learned from the pilot stage.

20.78 A national plan and a plan for each business window location were developed, covering all aspects of installing and operating the window. The national project team was in regular contact with staff and stakeholders throughout the country. The plans and project details were managed and monitored through regular contacts and meetings at all levels. Plans were

implemented on time for the most part and almost exclusively with existing resources. However, there was no cost-benefit analysis or formal business case prepared for the business window project. The Department did not feel this was required since it viewed the business window as a strategic investment.

20.79 A national service delivery model (part of the national plan) was developed to form the basis for each business window. The model specified that the establishment of the business window would not reduce service levels. Before the business window, there had been separate service levels for Customs and Excise and for Taxation lines of business. One limitation of the model was that it did not define which of the prior service levels would apply to the business window. (See also paragraphs 20.90 to 20.97.)

Business windows provide business clients with a single point of service over the counter (see paragraph 20.74).



Generally good employee communications and involvement

20.80 An internal communications plan was developed to keep managers, employees and unions aware of progress on the project. Specific activities included the use of electronic bulletin boards, printed newsletters and on-site information sessions. Despite these efforts, some staff in offices we visited complained about the information available to them on the project's implementation. These staff wanted to be provided with current information on an ongoing basis.

20.81 A significant number of employees were involved in the various projects and committees created to develop the business window. Regional co-ordinators, local co-ordinators, local and regional teams and pilot project teams were established. In some offices, union representatives were part of the management team.

20.82 Teams were set up in each of the six regions, and every local office had an implementation team. The level of staff involvement in implementation varied from office to office depending on how the team was set up. The majority of the staff we interviewed indicated that they had been adequately involved. Some staff indicated that their involvement had been limited and they felt they should have had more influence on the outcome.

Stakeholders adequately informed and involved

20.83 Significant efforts were made to inform clients and other stakeholders through national mailouts and consultations. In addition, there were regional and local consultations with the various business and professional associations. Feedback was also obtained

through a stakeholder survey and the ongoing use of client comment cards.

Not enough attention to the impact of combining different work cultures

20.84 Administrative consolidation brought together the 14,000 full-time equivalents in Customs and Excise and the 25,000 in Taxation. (The Customs and Excise department had consisted of 9,000 full-time equivalents in Customs and 5,000 in Excise.) Customs and Taxation are long-standing programs; GST, the largest component of the Excise program, was introduced in 1990. The implementation of the business window combined staff from GST and Taxation.

20.85 As noted previously, the organizations had different histories, organization structures, computer systems, compliance policies and levels of authority. All of these contribute to establishing the work culture. Work culture affects all aspects of work including interaction among people. (It should be noted that most of the Customs operations remain separate and therefore are less affected by the combining of cultures. Customs had limited involvement in the business window.) We chose to look at issues involving work culture in our audit of the business window because it was a good example of a situation that involved people from various cultures having to work together.

20.86 The Department made some effort to deal with the cultural differences. It established a support network of change counsellors across the country to assist managers and employees, including those in the business window, in understanding and coping with changes in the organization. In addition, individual offices took a variety of steps to deal with the cultural differences. For example, at least one office had staff from the former two departments get together to discuss

The level of staff involvement in implementation varied from office to office depending on how the team was set up. The majority of the staff we interviewed indicated that they had been adequately involved.

Size differences added to cultural differences.

and become familiar with each other's cultural differences. Also, several regional work teams held sessions on team building and resolution of conflict.

20.87 In spite of these efforts, employees in the business window raised many concerns about the cultural change. Many GST staff expressed a "feeling" of takeover by Taxation. There were frequent comments about having to move from the newer GST facility to the older, sparser Taxation facility, and having to do without such things as faxes and photocopiers. Dress codes, rules of conduct, and hours of work also changed. As well, the time reporting and production measurement systems adopted by the new organization came from Taxation. Even though the Department felt the decision on the systems was justified, it had the effect of reinforcing the feeling of takeover.

20.88 Size differences added to cultural differences. There was a perception that larger organizations are more formal and less personal. Business window staff from the former GST offices believed that their previous organization was more closely knit and had more informal communications among divisions than the new, combined organization.

Combining cultures cannot happen in a short time and will take several years to accomplish.

20.89 Comments from staff at the business window clearly indicate that they would have benefited from more up-front discussion about combining the cultures. However, we recognize that combining cultures cannot happen in a short time and will take several years to accomplish.

Improved accessibility of counter service but continuing concerns about telephone service

20.90 The business window has improved access to counter services now that clients can obtain all information and services at one location instead of several.

In addition, 10 more cities now have access to counter services for the four business programs where it used to be available for only one. These service improvements should reduce the cost of compliance for most business taxpayers who use more than one counter service.

20.91 One objective of the business window project was to maintain the existing level, grade and quality of telephone services during implementation. The level of telephone service measures a caller's chances of getting into the queue to speak with an agent; the grade of service measures the length of time before the call is answered; and the quality of service refers to the accuracy of the answer. Before the introduction of the business window, the four programs provided different levels, grades and qualities of service. However, we found that although the grade of telephone service for GST enquiries has remained the same since the opening of the business window, the level of service has declined.

20.92 Our interviews with staff and review of documents revealed a continuing concern about meeting the telephone demand. Budgets for client services are being reduced, which threatens to reduce the level and grade of service. Next year, the Department plans to test an automated voice response system to respond to client enquiries and to direct others to the appropriate area for service. As well, the Department intends to give more comprehensive training to business window staff. The Department expects these efforts, along with the increased knowledge and skills that staff gain from experience, to deal effectively with resource reductions without further deterioration in service levels.

20.93 We looked at telephone response rates (level of service) after the business window opened. Our review indicated that

in the offices we visited where records were kept, the likelihood of getting through on a local call for all programs ranged from 15 percent to 28 percent. We compared these results with the only available data on previous levels of service, an internal study of GST telephone enquiries completed shortly before implementation of the business window. The study was based on a survey conducted in January and February 1995. It indicated that previously, for the same offices, the likelihood of getting through on a local call had ranged from 31 percent to 99 percent. In all our visits, staff in the business windows indicated concern about their inability to answer calls.

20.94 The Department has also gathered data on 1–800 response rates since the implementation of the business window. These data show average response rates, by office, ranging from 26 percent to 99 percent for the periods sampled. Comparable information prior to the establishment of the business window for the 1–800 number was not available.

20.95 We also looked at wait times (grade of service) after the implementation of the business window. Our review indicated that, in the offices we visited where records were kept, the wait times ranged from 62 to 199 seconds. We compared these results with the above-noted internal study of GST telephone enquiries. That study indicated that previously, for the same offices, the wait times had ranged from 36 to 204 seconds. (Comparable information prior to the establishment of the business window for the other major line of business, payroll deductions, was unavailable.)

20.96 A GST study conducted shortly before implementation of the window stated that 48.6 percent of the answers given had been fully correct, 27.6 percent partially correct and 23.8 percent

incorrect. We were not able to obtain any comparable post-implementation statistics on accuracy. The Department plans to conduct a survey early in 1997 to determine the level of accuracy of responses given.

20.97 Business window cost per transaction is monitored locally, regionally and nationally. Business window service response is monitored locally and sometimes regionally. Efforts are under way to establish national standards for service response, but these had not been completed as of June 1996. We expect that these efforts will include consultation with stakeholders. Once the service response standards are established, the Department expects that the results will be monitored locally, regionally and nationally.

Additional training needed

20.98 The operation of the business window requires a general knowledge of all four of the Department's major lines of business, but staff had previous training in only one. Accordingly, a training program was established for the pilot stage, consisting of six modules and lasting approximately five days. The training program for the pilot was validated and refined for national implementation, based on an employee survey and comments from pilot trainers and trainees.

20.99 Despite the refinements made, many of the staff stated that they needed more training in the areas that were new to them in order to respond confidently to client enquiries. Where extended classroom training was provided, staff said they were more comfortable answering questions. Additional training could be provided on the job through regular group or team discussions, coaching, and pairing of more experienced staff with new staff members.

Efforts are under way to establish national service standards.

**Officers performing
equivalent duties are
in positions classified
at different levels.**

**Revenue Canada slow to determine
classification of business window staff**

20.100 All front-line business window enquiries officers are classified as either PM1s or PM2s. The PM2s are more senior-level service providers whose pay range is higher than that of PM1s. These PM1 and PM2 officers first obtained their classification based on the descriptions of their jobs that existed prior to administrative consolidation and their assignment to the business window. Job descriptions were amended and classification levels were reviewed when staff went into the business window.

20.101 Both PM1s and PM2s now handle a mix of level 1 and level 2 enquiries in the business window. (Level 1 enquiries include non-complex topics from each program; level 2 enquiries are generally more complex and often require specific account adjustments and/or specialized technical knowledge of a particular topic). This has resulted in officers who do equivalent duties being in positions classified at different levels. This situation is perceived as inequitable and is disturbing to employees.

20.102 Revenue Canada has been slow to resolve this matter. The Department explains that this is due to the use of a process involving employee consultations in its development of national jobs, and the need to align these jobs with other jobs in the Department. The Department informed us that in August 1996, two new job descriptions will be implemented to operate in the window, one a Client/Business Services Agent (PM1) and the other a Senior Business Services Agent (PM2), with clearly differentiated responsibilities. They will replace the amended job descriptions currently in use. The Department expects that employees now classified at the PM2 level will be assigned to PM2 jobs.

Conclusion

20.103 Administrative consolidation has been and continues to be a challenging task for staff at all levels of Revenue Canada. Our audit of three key aspects of the process indicates that, for the most part, the Department is managing this task well and meeting the objectives it set for itself.

20.104 Administrative consolidation has established a solid foundation for streamlined operations. Combining the two departments has eliminated major duplication of functions in both headquarters and field operations. Introduction of the single business number is expected to reduce the paperwork and time required for collecting, accessing and processing information.

20.105 The business number has created new possibilities for integrating information and services in Revenue Canada, the federal government and the provinces. A number of these possibilities are already being explored.

20.106 The business number and business window are providing simplified and more accessible service to Revenue Canada's business clients. Improvements in telephone service at the business window are still required. The classification of business window staff needs to be resolved as soon as possible.

20.107 While the process is not yet complete and a number of areas require improvement, administrative consolidation has provided the Department with valuable experience in managing organizational and technological change. Much of this experience could be usefully applied by other departments and agencies facing similar challenges.



About the Audit

Objectives

Our audit objective was to examine whether the process followed in administrative consolidation was appropriate and adequately managed and whether the results of some of the significant administrative consolidation initiatives demonstrated that stated objectives were being achieved.

Scope

Our examination looked at three aspects of administrative consolidation: corporate management (the Department's steering of the whole administrative consolidation process), the business number and the business window.

The business number is a new business identifier that will be common to all accounts of each business. The business number is the foundation on which Revenue Canada can provide simplified, accessible and faster service to its business clients, and enhance its compliance programs. Other federal government departments and provincial governments have expressed an interest in using the business number in their operations. Our goal was to look at whether the foundation is solid enough.

Business windows are new, single-window service sites opened across the country to provide Revenue Canada's business clients with registration and enquiries services. The business window represented an opportunity for us to examine the process of bringing together departmental areas that provide service to business and to look at how the Department handled issues affecting its staff and clients.

Criteria

In bringing together two organizations to form one:

- There should be a discernible vision of administrative consolidation that is consistent with government priorities.
- Senior management should demonstrate its commitment to and involvement with administrative consolidation.
- Senior management should inform staff, including union representatives, and stakeholders about the direction and status of administrative consolidation and involve them in its design and implementation to the extent practicable.
- The new organization should have plans for administrative consolidation that are consistent with the vision, and should respect legal authorities throughout the administrative consolidation process.
- Significant projects should be supported by cost-benefit analysis.
- Projects should be split into manageable sub-projects; staffed with capable project teams; delivered according to plan; and monitored and evaluated.

- Administrative consolidation should take place in such a way that required operations continue to be delivered at specified standards, facilities meet operational needs and adequate resources are provided to complete the consolidation.
- The Department should ensure that in managing the human resource change process it handles with some sensitivity the existing operational and cultural differences and the placement of people in the new organization.
- There should be sufficient staff with the required skills available when needed to deliver operations to the desired standard.
- The organization design for the consolidated department should provide for elimination of duplication.
- Systems and practices should ensure there is a solid foundation for implementation of management's overall vision and plans and for the efficient delivery of operations.
- Results attained should be measured and compared to the results anticipated.

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